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THE IFF CHINA REPORT 2019

INTERNATIONAL FINANCE FORUM (IFF)
Since 2003

THE IFF CHINA REPORT 2019

Insight and perspectives from the world’s leaders, premier policy-makers and financiers

- New globalisation – The path to the future
- Redesigning the international trading and monetary system
- The Belt and Road Initiative
- Financial deepening, fintech development and green financing
- The Bay Area Development

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ZHOU Xiaochuan
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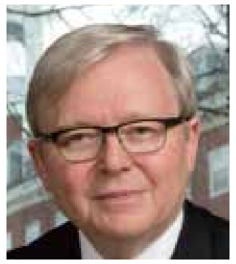
Former Vice-chairman of the CPPCC
Former Governor of the People's Bank of China



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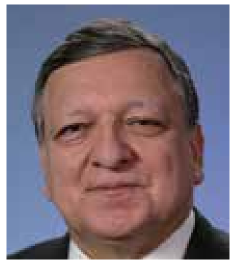

José Manuel Durão Barroso
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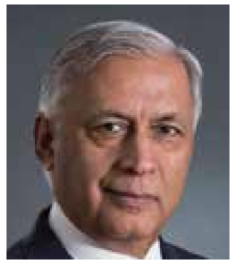
Former President of the European Commission
Former Prime Minister of Portugal

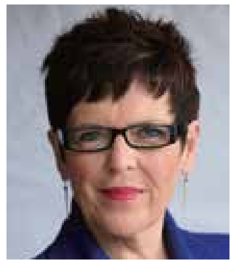
Han Seung-soo
Co-chairman of IFF
Former Prime Minister of Republic of Korea
Former President of UN General Assembly



Shaukat Aziz
Co-chairman of IFF
Former Prime Minister of Pakistan

LI Xiaohong
Vice-chairman of IFF
Former Vice-chairman of the CPPCC Beijing Committee

ZHU Guangyao
Vice-chairman of IFF
Former Vice Minister of the Ministry of Finance of China
Former Deputy Director of Office of the Financial and Economic Work of the Central Committee of CPC



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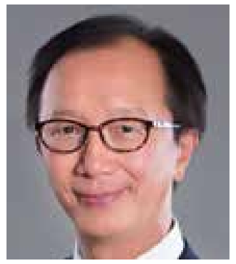
Former Prime Minister of New Zealand

JIANG Yang
Vice-chairman of IFF
Former Vice-chairman of China Securities Regulatory Commission
Head of the Group for the Establishment of China Securities Museum

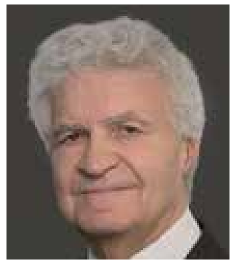
CHEN Wenhui
Vice-chairman of IFF
Deputy Secretary-General of National Council for Social Security Fund
Former Vice-chairman of China Banking & Insurance Regulatory Commission

ZHOU Hanmin
Vice-chairman of IFF
Vice-chairman of CPPCC Shanghai Committee

ZHU Xian
Vice-chairman of IFF
Vice-president of New Development Bank
Former Vice-president and Chief Ethics Officer at World Bank Group



Antony Leung
Vice-chairman of IFF
Former Financial Secretary of the Hong Kong Special Administrative Region



Edmond Alphandery
Vice-chairman of IFF
Chairman of Euro 50 Group
Former Minister of Economy of France

Domenico Siniscalco
Vice-chairman of IFF
Former Minister of Economy and Finance of Italy
Vice-chairman of Morgan Stanley International Limited

Sultan Bin Nasser Al Suwaidi
Vice-chairman of IFF
Former Governor of Central Bank of the United Arab Emirates

* List above includes IFF board members and annual meeting guests

US-China relations key to prosperous global economy

The release of the fourth edition of the *IFF China Report* comes at a critical period for China-US trade negotiations, and at an important juncture in trade and investment relations between the world's economic powers.

The collaborative spirit that prevailed in the immediate aftermath of the global financial crisis that resulted in a more proactive Group of 20 and co-ordinated policy action has diminished. Slower global growth and increased levels of inequality, particularly within nations, has resulted in increases in nationalistic and inward-looking policy-making.

In particular, the traditional global rulemaker, the US, has engaged in a series of efforts to reset long-standing trade relations that it now believes are unfair. Indeed, its ongoing trade dispute with China – the US moved to impose tariffs on an additional US$200 billion of Chinese imports in September 2018 – hangs like a storm cloud over the global economy.

A number of officials on both sides believe a trade deal is within reach ahead of the next US tariff increase – particularly after the US delayed its own deadline for escalation originally set for March 1. But potential obstacles remain, including the US being prepared to quickly roll back existing tariffs and China's willingness to genuinely open up its markets, especially in the area of technology and, to a lesser extent, financial services.

A trade deal has the potential to reset recent China-US relations and bolster confidence in the global economy. However, even if a deal is reached, tension between the world's two largest economies has the potential to flare up again, with obvious faultlines related to areas such as intellectual property, market access, state subsidies and national security.

The ability to resolve disputes in a peaceful and productive manner will be vital moving forward. To achieve this, multilateral mechanisms will require upgrading.

The *IFF China Report 2019* aims to offer insights and perspectives regarding some of these important developments, offering the thoughts of contributors based in China and many other nations. To reflect this focus, the report is divided into five sections: New globalisation – the path to the future; redesigning the international trading and monetary system; the Belt and Road Initiative (BRI); financial deepening, fintech development and green financing; and the Bay Area Development.

The *IFF China Report 2019* also includes the second annual BRI Survey of central banks. The results from the survey indicate that the 28 central banks that responded are relatively sanguine about some of the rhetoric that has emerged regarding the BRI during the past couple of years. They universally viewed the BRI as an important measure promoting globalisation, and indicated BRI projects in their jurisdictions were free of political and financial pressure.

That may change. The negative US reaction to the decision in March by Italian prime minister Giuseppe Conte to sign a non-binding memorandum of understanding aimed at increasing Italy's participation in the BRI – making it the first G7 nation to do so – highlights a likely source of tension moving forwards.

We are, once again, privileged and extremely grateful for the support of the global leaders, policy-makers, finance experts, business leaders, politicians and scholars who have contributed to and supported the publication of the *IFF China Report*. We hope it provides you with important insights and fresh perspectives.

Zhang Jizhong
IFF chief executive officer and secretary-general

Christopher Jeffery
Editor-in-chief, Central Banking Publications


Edmond Alphandéry
IFF vice-chairman, chairman of the Euro 50 Group, and former finance minister of France


Sultan Bin Nasser Al Suwaidi
IFF vice-chairman, and former governor of the Central Bank of the United Arab Emirates


Gloria Macapagal Arroyo
IFF board member, former president of the Philippines, and speaker of the House of Representatives of the Philippines


Shaukat Aziz
IFF co-chairman, and former prime minister and finance minister of Pakistan


Dipak Banjade
Acting consul general at the Nepalese Consulate General, Guangzhou


José Manuel Durão Barroso
IFF co-chairman, former president, European Commission, and former prime minister and foreign minister of Portugal


Cai Chaolin
General director, Administrative Committee of Guangzhou Nansha Free-Trade Zone


Javier Guzmán Calafell
Deputy governor, Banco de México


Nadav Cohen
Consul general at the Israeli Consulate General, Guangzhou


Massimo D'Alema
Former prime minister of Italy


Denis Depoux
Deputy head, Asia, Roland Berger


Han Seung-soo
IFF co-chairman, former prime minister of the Republic of Korea, and president of the 56th session of the UN General Assembly


Nicholas Hope
IFF Academic Committee member, former director, Stanford Center for International Development, and former director, China programme of the World Bank


Jiang Yang
IFF vice-chairman, and former vice-chairman, China Securities Regulatory Commission


Ashfaque Hasan Khan
Former finance minister of Pakistan, and member of Pakistan's Economic Advisory Council


Antony Leung
IFF vice-chairman, and former financial secretary, Hong Kong Special Administrative Region


Li Dongrong
President, National Internet Finance Association of China, and former deputy governor, People's Bank of China


Li Yang
Director, National Institution for Finance and Development

2019 Contributors


Lu Lei
Deputy administrator, State Administration of Foreign Exchange


Luo Yang
Managing director, Silk Road Fund


Ma Rupei
Former deputy director, Overseas Chinese Affairs Office of the State Council of the People's Republic of China


Shakirudeen Adewale Oloko
Consul general at the Nigerian Consulate General, Guangzhou


Qiu Yitong
Director, Bureau of Financial Affairs, Guangzhou Municipality


Harley Seyedin
Special adviser to the chairman, George HW Bush Foundation for US-China Relations


Sun Shilian
Researcher, Xinhua News Agency World Research Centre


Maksat Ishenbekovich Tentimishov
Consul general at the Kyrgyz Consulate General, Guangzhou


Robin Xing
Chief China economist, Morgan Stanley


Adam Yousif
Consul general at the Sudanese Consulate General, Guangzhou


Zheng Zhijie
President, China Development Bank


Zhou Chengjun
IFF Academic Committee member, and deputy director, Research Institute, People's Bank of China


Zhu Guangyao
IFF vice-chairman, and former vice-minister, Ministry of Finance of China


Zhu Xian
IFF vice-chairman, and vice-president, New Development Bank

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United Kingdom

International Finance Forum
Ziyuntai-IFF Center
Haidian District
Beijing 100095
China

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New globalisation – The path to the future

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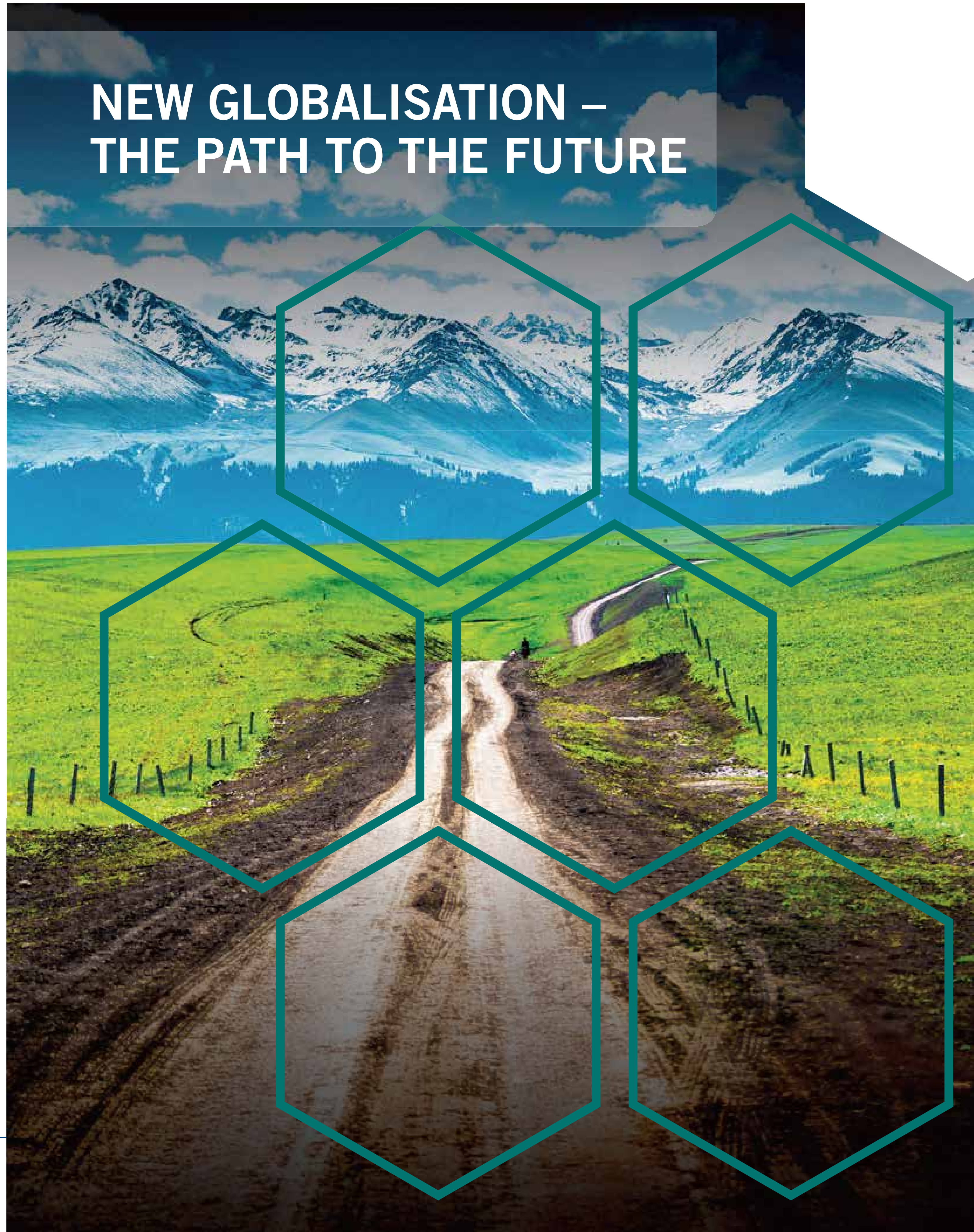


New globalisation – The path to the future

Full circle – Globalisation rises again in the East

Globalisation was conceived on the ancient Silk Route, and now China will once again be the driver and innovator of a new world order, predicts *Gloria Macapagal Arroyo*, IFF board member, former president of the Philippines and speaker of the House of Representatives of the Philippines

The British historian A.G. Hopkins traces the beginnings of globalisation to the East – as far back as the Silk Route of the Han dynasty 2,000 years ago. But, for post-colonial globalisation, the first watershed event was the Bretton Woods Conference in 1944, which sought to design the new global financial order after World War II. The war had seen a struggle between two political systems in the West. On one side were countries such as the UK and the US, which were founded on a liberal political philosophy and an economic system of free trade. On the opposing side were countries oriented towards a rightist political philosophy and an economic system tending towards centralisation, such as Germany and Italy.

The US emerged from the war and the Bretton Woods Conference as the dominant player in the West, its economic ideas embodied in institutions such as the World Bank, the International Monetary Fund and the General Agreement on Tariffs and Trade.

During the Cold War, the West was challenged by a new East: no longer colonial, but still reflecting political and economic thinking that was different from the West. The term 'globalisation' appeared in the dictionary for the first time in 1961, although it was rarely used for three decades.

In 1978, China launched its bold policy of reform and 'opening-up'. Paramount leader Deng Xiaoping explained in 1984: "The present world is open. One important reason for China's backwardness after the Industrial Revolution in Western countries was its closed-door policy."

Another watershed event in post-colonial globalisation was the fall of the Berlin Wall in 1989, which signified the West's victory in the Cold War. The Western economic system stood on the verge of total global dominance and, less than a decade later, the Western concept of globalisation was enjoying its heyday, perhaps its high-water mark, embodied in the World Trade Organization and regional groupings such as the Association of Southeast Asian Nations Free-Trade Area (AFTA).

During this pinnacle of globalisation in the mid-1990s, the Philippines lowered its tariffs even beyond its commitments under AFTA. But by the time I became president of the country in 2001, the aftereffects of the 1997 Asian financial crisis and the events of September 11, 2001 were making themselves felt, and the Philippines' fiscal, external and trade position had weakened.

Thus it was now up to the domestic economy and manufacturing sector, which my government encouraged with tariff signals. I slowed the pace of the trade liberalisation programme to AFTA minimums, and took full advantage of all permitted exemption windows, such as for our proposed naphtha-cracking technology.

I favour globalisation and free trade. But not all countries are at the same stage of economic, political and social development, so the ideals of globalisation and free trade must sometimes be tempered by the realities within individual countries. Each country must judge for itself how to respond to globalisation, and at what pace. By making such adjustments, the Philippines has stayed the course of globalisation and is now looking for ways to build an environment inclusive and beneficial to small and medium-sized enterprises.

Economic globalisation – Challenges and prospects

Looking into the future, two developments stand out as particularly interesting. Since 1978, when it first opened up, China has risen to become the world's second-largest economy. I visited China in the mid-1970s, and have witnessed the entire breathtaking history of its 40-year achievement. China's success raises a question: in the face of widely accepted dogma that the best path to development is the Western model of government and globalised economics, what are we to make of the phenomenon that is China?

China's transformation is a triumph of socialism with Chinese characteristics for a new era. In defining this system, Deng said: "The fundamental task for the socialist stage is to develop the productive forces." He added: "Our experiences show that China cannot rebuild itself behind closed doors and it cannot develop in isolation from the rest of the world."

Socialism with Chinese characteristics means reform and opening-up. Now, just as the historian Hopkins emphasised globalisation has non-Western as well as Western origins, 21st-century globalised economics is no longer just a Western model.

The second development is the rise of anti-globalisation or anti-open border sentiment in favour of old-style nationalism in the US and some parts of Europe. Is this a passing phase, or has the pendulum really begun to swing the other way? Protectionism has emerged in the US, previously the champion of globalisation, and pessimists now speak of the end of economic globalisation.

But President Xi Jinping has reaffirmed that China will continue to open up, and protectionism in the US provides China with a reason to step up its support to the Regional Comprehensive Economic Partnership (RCEP), now potentially the world's largest economic bloc.

Gloria Macapagal Arroyo

New globalisation – The future path

More optimistic analysts point to a new type of globalisation, driven as much by the East as the West. That is not far-fetched, given that China is on the verge of becoming the largest economy in the world. The history of globalisation will then come full circle, from the original Silk Route to the Belt and Road Initiative (BRI) of today. Indeed, some experts describe the BRI as 'globalisation 2.0'.

Amitav Acharya, a distinguished professor of international relations at American University, Washington, DC, has said the term globalisation 2.0 is more about investment, infrastructure and development than merely trade. This is consistent with my view that trade and investment relationships – for example, those governed by regional agreements such as RCEP – are the 'software' that provides a framework for world trade and investment to thrive within. But 'hardware' is also needed, and this is where the BRI can contribute, building the bricks-and-mortar infrastructures without which international trade and investments cannot flourish.

Consulting firm McKinsey suggests that, rather than globalisation being in retreat, it is becoming a more digital phenomenon. In this new globalisation, it is no surprise Tencent and Alibaba are among the 10 most valuable companies in the world, given China's fertile environment for technology.

China has demonstrated to the world rapid economic growth and modernisation is possible through a combination of vision, political will, and open and responsible relations with other nations. President Xi's attitude is that, as China becomes a fully modern economy, it will simultaneously strive for partnership in growth and development with its neighbours. This enlightened attitude provides a foundation for the future path for the new globalisation.

New era, new order, new future

The world must decide if it wants to exist under a multilateral rules-based system of justice and fair competition, or descend into populism and chaos, writes *José Manuel Durão Barroso*, IFF co-chairman, former president of the European Commission, and former prime minister and foreign minister of Portugal

We are living in a very particular and distinct period: this is certainly not the first era of globalisation the world has known, but it is unprecedented because of its scope, intensity and speed. China's rapid economic rise is one of the clearest demonstrations of this. Comparing the events of today with those of previous eras of globalisation – when the world seemed to become more connected, such as during the Industrial Revolution – we see that the intensity and speed of globalisation is much greater than previously.

We are still experiencing some of the effects of the 2007–08 financial crisis, which was triggered, among other factors, by the collapse of Lehman Brothers. The crisis had one extremely significant impact in Europe: the financial and sovereign debt crisis. At that time, there was a clear need to create a new institutional infrastructure to deal with this global crisis, using the Group of 20.

Meetings of the G20 had already been taking place between finance ministers since 1999, but not at the level of heads of state or government. Myself, then president of the European Commission, and the then president of France, Nicolas Sarkozy, asked US president George Bush to organise the first G20 summit of heads of state and government in Washington, DC. Since then, the G20 summit has taken place annually, and has established itself as the premier global economic forum. The Group of Eight was no longer able to provide a co-ordinated global response to the challenges being faced: other major economies – China, for example – were not represented. Since then, each year, efforts have been made for global, co-ordinated action through the G20 summits.

I had the privilege of participating in all of the G20 summits until I left the European Commission in 2014. They have performed a very important role: attempting to avert a return to full protectionism, as occurred in the 1930s. There was a growing intensity in the movement towards protectionism during the financial crisis; but we have not seen an immediate return to full, hard protectionism.

To a large extent, that has been a result of co-ordinated action from G20 leaders. Efforts were also made to ensure greater financial stability, such as the establishment of the Financial Stability Board in 2009. Although it was not perfect, a design was certainly initiated, a kind of global framework for sustainable growth.

A golden age of co-operation

It was a period of true co-operation and attempts at co-ordination – the first time I had seen heads of state and government from all over the world not formally reading prepared speeches, but engaging in free discussion: What can we do to avoid making this financial crisis worse? What can we do to sustain the possibilities of growth? In Europe, it struck us as a very acute crisis – with doubts about the future of the euro – and the summits felt like the appropriate response. Europe and the European Union felt that China was supporting all of the efforts for stabilisation in the EU and eurozone.

At that time, we had many important conversations with the Chinese authorities at the highest level, including the People's Bank of China. We believed in the support of China, and in the efforts China could make in sustaining the global economy.

Is the same spirit alive in the G20 today? I'm afraid not. Not only in Europe but in many of the parts of the world, populism has returned. Sometimes it is called 'nativism' – the granting of primacy to native populations – forgetting we are all globally linked. We are seeing more nationalism, protectionism and greater tensions. We need to respond to it with ideas, vision and a new infrastructure. The idea is based on multilateral governance, and we need to remain firm in defending a multilateral approach, rejecting unilateralism and even bilateralism.

The move towards unilateralism or bilateralism is not a recent phenomenon: the failure of the Doha World Trade Organization (WTO) talks saw the international community refuse a global trade agreement as some members were not ready. And now the temptation is not only to make bilateral agreements, but sometimes to even go against those bilateral trade agreements.

It is necessary to sustain a multilateral order based on the multilateral approach, which means a multilateral order based on commonly accepted, respected and enforced rules. I am concerned by the current situation of the WTO as it lacks the necessary support for its Appellate Body, which attempts to solve conflicts between its members.

We need to reinforce this global governance – not only at an international but at a national level – because these issues are linked. It's an illusion to think we can solve all the problems of global governance without addressing matters of internal governance – for instance, governance based on the rule of law – so the blame for the failure of global fair competition can be laid in as many areas as possible.

José Manuel Durão Barroso

Competition is of course unavoidable; it will always exist in the international community. The question is whether this competition will take place in the context of a rules-based system, with predictability and stability. Or are we going to watch competition in a global context of confrontation?

Those who believe in the values of openness should work towards a stable rules-based system where we can make predictable decisions and work within the framework of stability. First, it is important to support the UN, the International Monetary Fund, the WTO and other multilateral institutions, and to support all mechanisms and institutions working towards this multilateral approach.

Second, we should work towards increased connectivity, building the necessary infrastructures, not only in transport and in digital matters, but in other areas that bring the world together. And I believe the trend will be in that direction.

But now we are in a very particular moment of international development, because we are in a situation where the old order no longer works, but there is not yet a new order that delivers or even offers an alternative. We are in the middle of this transition and, by definition, transitions generate anxiety and doubts, and create uncertainty.

Uncertainty today is, unfortunately, the rule rather than the exception when you look at the global order. Probably the greatest risk today to global growth is a lack of predictable rules and a stable system. This anxiety and uncertainty is already fuelling scepticism from the business community and investors, and it can easily spread – a problem for sustainable growth.

> *We are no longer in a situation where we can say 'our' countries and 'other' countries, that 'your' part, 'your' side of the boat is sinking. No, we are in this together*

In the end, we must decide whether or not we want to live in an open world in a rules-based system. It's a political and even a broader cultural question – are we going for openness or the opposite of openness? I share the EU's desire for openness.

Enter China

China has a very important role to play here. Of course, China must decide its own course of action. Having said that, last year was the 40th anniversary of China's policy of 'opening-up' and reform. My opinion is that China's structural growth prospects lie in its commitment to pursue market-based reform. This commitment drives its long-term growth trajectory, which is very important not only for China, but for the global economy. So, from a European perspective, I would encourage China to continue the movement of opening-up and reform, including for foreign companies – including those in the financial sector. I believe this process can make an important contribution to creating and reinforcing the level playing field we need for development and progress in terms of trade and a global order based on certainty.

So we are now watching this global struggle between flow and friction. There is flow on one side, the flow of trade in goods and services, the flow of international travel, of communications, human contacts, cultural and scientific contacts, and so on; and on the other side, there is friction. But there is also resistance because there is movement, and I truly believe the stronger impetus in the future will be for a globalised, more interconnected world.

The world faces so many important problems, from climate change to financial instability, trade frictions to international terrorism and pandemics. So many problems are global and require solutions and mechanisms that go beyond national borders. We are no longer in a situation where we can say 'our' countries and 'other' countries, that 'your' part, 'your' side of the boat is sinking. No, we are in this together.

That's why we need a global approach that creates the necessary stability for trade, investment and sustainable growth – not forgetting the least developed countries that need the support of the more advanced, major economies to sustain their own development. It is to be hoped that through this can come not only a world of peace, but a world based on the principles of justice.

The need for a new multilateralism

Globalisation has made the planet richer and more interconnected, but it has also led to growing inequality, climate change, terrorism and a populist, protectionist backlash in developed nations. Only a new multilateralism can solve these problems, writes *Han Seung-soo,* IFF co-chairman, former prime minister of the Republic of Korea and president of the 56th session of the UN General Assembly

The UN headquarters from the East River, New York

Globalisation did not suddenly happen – it has deep roots in history, with the process of globalisation becoming a defining feature of international relations towards the end of the 19th century. Revolutionary progress in transportation and communications technology rendered national boundaries increasingly irrelevant for most economic, commercial and cultural purposes.

Globalisation has been driven not only by this rapid technological change, but also by drastic geopolitical and socio-economic shifts.

With the demise of the doctrine of economic control and planning, the free market principle and system have gradually become the unchallenged platform being adopted globally. In international trade and finance, the market economics principle calls for free trade and liberalised capital markets. Indeed, the idea of free trade and free movement of capital across national borders has become the norm of economic activity the world over.

The root of globalisation

The governing principle behind this new international order is, at root, non-ideological and market-friendly compared with the period prior to the collapse of the Soviet Union around 30 years ago. It is instructive to recall that the pre-World War I international order was also basically non-ideological. All the major players were capitalist; even imperial Russia was rapidly industrialising along capitalist lines. The global system was then, as now, 'increasingly interdependent', to use a hoary cliché.

The successful conclusion of multilateral trade negotiations under the General Agreement on Tariffs and Trade (GATT) and the 1989–94 Uruguay Round of GATT negotiations – which culminated in the creation of the World Trade Organization (WTO) – contributed to furthering the globalisation process. Compared with previous trade negotiations, the Uruguay Round was particularly significant to the process in developing countries. Until then, the multilateral trade negotiations had been the major concern only of developed countries.

It was through the Uruguay Round that developing countries were required to improve their trade-related institutions and policies. Although developing countries were disappointed at the outcome of the negotiations, it was during this period that they further lowered their tariffs on manufactured goods and became more disciplined in observing intellectual property rights in return for the abolition of quotas on textiles and clothing, and in subsidy policy for the agricultural sector and others on the part of developed countries.

Relevant to this point is the establishment and growth of international economic institutions such as the World Bank, the International Monetary Fund, the Organisation for Economic Co-operation and Development, and the WTO and GATT. Above all is the UN itself which, though broader in focus, is no less concerned with economic factors conducive to war and peace. Nearly all of these institutions came into being after World War II. They set the rules of international trade and finance, serve as forums for negotiation and co-operation, and broadly act to minimise the possibility of unchecked economic competition becoming dangerously out of hand.

Another major factor that expedited the globalisation process was the economic integration that began in Europe soon after World War II. The European Union and its predecessors have had a great impact on regional movement and integration. The European Economic Community that was established with the Treaty of Rome in 1957 has moved through the stage of being a customs union to an economic union, resulting in what is now the EU. Through the Maastricht Treaty of 1992, the sphere of integration that began with the economic area was broadened to include political and security areas. With the launch of the common currency – the euro – in 1999, European economic integration was further intensified. The successive harmonisation of various systems and policies in the EU has increasingly rendered inter-European borders redundant, contributing to the free flow of goods and services, capital and labour within Europe.

Han Seung-soo

Managed expansion

Lessons learned from the European experience increasingly convinced other regions that the benefits of integration – economic or otherwise – were substantial. Indeed, many regional integration arrangements began to proliferate in Asia, the Americas and Africa, increasing the acceleration of the globalisation process.

To emulate the successful experience of European integration, the Association of Southeast Asian Nations was formed and has been active in integrating the regional economies and other sectors of its member states. The formation of free-trade areas such as Mercosur – the Southern Common Market in Latin America – in 1991 and the North American Free Trade Agreement in 1994 are other such examples.

In the Asia-Pacific region, the Asia-Pacific Economic Cooperation (APEC) is a prominent forum that contributes to the expansion of globalisation. As the Republic of Korea's minister of trade and industry, I was one of the initiators of APEC in 1989. We wanted it to be an example of open regionalism. APEC was instrumental in mobilising members' efforts to expedite the conclusion of the Uruguay Round. Although it was initially established as a very loose forum, it has since been widening its area of activities.

The rapid developments in information and communications technology have also propelled the progress of globalisation in recent years. The widespread use of the internet and other electronic means of communications, for example, has helped rapidly globalise capital markets. The digital revolution and its swift dispersal throughout major developed nations has helped to not only create a cyber space, but also condense the world into a village in all areas of human activities. The widespread use of smartphones is another significant cause of the rapid cross-border pollination of economic and social cultures, providing a link with a world beyond national borders.

A blessing and a curse

Globalisation, however, is a double-edged sword. While enhancing the wellbeing of mankind in general, the globalised world has posed serious challenges to nations as well as to individuals. Although economic globalisation is the most self-evident phenomenon that seems to bring about benefits to humankind, it is becoming increasingly clear that the distribution of the benefits from globalisation is not always equal within and among nations. There are also non-economic factors stemming from the globalisation process that overshadow the more beneficial aspects of globalisation.

The process of globalisation, as it influences the interaction among nations today, substantively affects the UN's agenda. Many of the issues being discussed by the UN reflect such challenges. Minority groups, the aged and children are among those most seriously affected by the by-products of globalisation, and the issues of environmental protection, poverty eradication and HIV/Aids have long been on the UN's agenda.

International terrorism has also surfaced as one of the crucial issues created by the process of globalisation that must be dealt with urgently through closer and tighter international co-operation. Indeed, the events in the US of September 11, 2001 are a perfect representation of the undesirable effects of globalisation. As evidenced in the case of 9/11, globalisation furnished international terrorism with easy access to loopholes in integrated systems. With terrorist organisations spread across national borders, national-level countermeasures became much less effective. It is also easy now for international terrorists to seek safe haven in failed states. Unless counterterrorist measures are conducted at a global level, it will be exceedingly difficult to combat international terrorism.

Another typical area in which the negative aspect of globalisation is evident is information technology. Although it has expedited the globalisation process, deep divisions exist within and among nations caused by the development of this technology. Enormous regional disparities in the capacity to use these new technologies – the so-called 'digital divide' – continue to grow.

Essentially, globalisation is a synonym for efficiency. The real concern with globalisation is that it may not promote equity. At this critical juncture in world economic history, the beneficial impact of globalisation in recent years should not be discounted but, at the same time, the major concerns of underprivileged nations and individuals should be seriously taken into account if we are to rectify this situation.

Unfortunately, in recent years the unravelling of globalisation has become evident. Diverse trade barriers are being raised, and regional integration is undergoing a difficult period. Anti-globalisation is gaining greater support than ever before in major developed nations. For example, the UK's decision in 2016 to withdraw from the EU – Brexit – has shaken the foundations of the EU. The WTO has not been properly functioning for many years, with embryonic free-trade agreements frozen before their birth.

The longer these deglobalisation processes last, the more harm they will bring and the greater negative impact they will have on global welfare. It is therefore time for world leaders to apply their wisdom and fortitude to reverse the course of world trade, which has been regressing for some years. Their calls for action would surely benefit people worldwide as well as those in their own countries.

However, it is not just trade that has been deglobalising. There are many areas of shared problems: climate change, declining biodiversity, lack of clean water, oceanic degradation, cyber crime, terrorism, large-scale migration, tax evasion, and many others.

Fortunately, there have been multilateral efforts in recent years to deal with some of these global problems. World leaders gathered at the UN in New York in September 2015 to unanimously adopt the new global agenda.[1]

The digital revolution and its rapid diffusion throughout major developed nations has helped to not only create a cyberspace but also shrink the world into a village in all areas of human activities

The agenda acknowledged that we are facing immense challenges to sustainable development and our very existence. Billions of people continue to live in poverty, inequalities within and among countries are increasing, enormous disparities of opportunity, gender inequality, unemployment, global health threats, more frequent and intense natural disasters, spiralling conflict, violent extremism and humanitarian crises threaten to reverse many of the development gains we have made in recent decades. Natural resource depletion and environmental degradation – including desertification, drought, land degradation, freshwater scarcity and loss of biodiversity – add to the challenge for sustainable development and urgently require a new kind of multilateralism.

In addition, climate change is one of the greatest challenges of our time, and its adverse impacts – such as global temperature and rising sea levels, ocean acidification and increasing volatility of weather patterns – are putting the planet's ecological life support systems at risk. Fortunately, world leaders were gathered at the 21st Conference of the Parties of the UN Framework Convention on Climate Change in Paris in December 2015 to adopt the Paris Climate Agreement, the long-term goal of which is to limit the increase in global average temperature to well below 2°C compared with pre-industrial levels.

The new multilateralism will require the close co-operation of the global leaders, just as information and communication technology is rapidly making the world increasingly more interconnected in all fields of human activities.

1. UN, *Transforming our world: the 2030 agenda for sustainable development*, *https://sustainabledevelopment.un.org/post2015/transformingourworld*

A tectonic shift in balance

A new balance of power is being formed before our eyes. In the absence of strong global leadership, it is up to each of us to embrace inevitable change and stay ahead of the curve, says *Shaukat Aziz*, IFF co-chairman, and former prime minister and finance minister of Pakistan

The globalised nature of the world we live in has had a transformative impact at both a micro and macro level. The ripple effect of globalisation has spread far and wide, opening up markets to an unprecedented extent, creating new opportunities and lifting millions out of extreme poverty. It has helped construct a geo-economic 'new normal', which has been steadily transforming global affairs and having a profound impact on our global political map.

Shaukat Aziz

We are living in an ever-changing and increasingly complex world, with a new global paradigm that has gradually emerged since the end of the Cold War. The world order we have known for decades is changing and – with the advent of technological advances – this is happening at a greater pace than ever before. The geopolitical tectonic plates are shifting towards a new balance of power.

Thousands of years ago, Asia was the cradle of civilisation itself. It brought vast development to the world through the ancient Silk Route. Throughout history, Asia has continued to make crucial contributions to human progress, and is now at the centre of today's tectonic shift, as China is expected to become the largest global economy in around a decade.

On top of this, Asia's demographics, economic strength and increasing importance on the world political stage means it is poised to shape the new technological miracle we see unfolding – and become a driving force for peace and prosperity.

The path of greater collaboration

My experience both in and out of government has taught me that a multipolar world is better than a unipolar one. The existence of new world powers can only be a source of strength for all nations. And yet, where some should see opportunity, they see instead a risk to the status quo. Some countries have expressed concern about the prospect of the so-called 'Thucydides Trap' – the theory that when new powers rise, the risk of conflict increases.

Such a narrative is mistaken; perhaps 200 years ago it would have been appropriate, but the world has changed dramatically since then. The globalised nature of our interactions means traditional borders count for less. This has been particularly the case with technology, through the use of which you can have goods delivered from the other side of the world at the push of a button. The path to prosperity does not lie in insularity, but in embracing the opportunities of globalisation. Through this we can ensure competition, increase productivity and provide the incentive to innovate – ultimately making us better off collectively. The old status quo – in which countries constantly competed for influence – is becoming increasingly dated.

Instead, it is time to focus on moving to a new paradigm of interdependence and common interest. This involves working with – not against – each other. And this is not a policy pipe dream; it has already been gaining grass-roots support in most major developed countries.

The 21st century has the potential to see a historic shift away from strategic competition towards a path of greater global collaboration. However, for this to truly become part of our collective DNA, there must be a renewed focus on developing linkages and interdependencies, which can be achieved by encouraging trade, investment and interpersonal contact. This will help shore up a level of trust, which will be invaluable in the event of any future tension.

Everything I learned in and out of office has led me to believe that connectivity is the true safeguard of peace. We must remember that it is the responsibility of all powers to manage the transitions we face, and ensure they remain peaceful. Peace should always be the imperative – however our domestic priorities may differ. It is through working together, not undermining each other, that we can get ahead.

The Belt and Road Initiative (BRI), unveiled by President Xi Jinping in 2013, has set a new standard for global co-operation, which should be mirrored by countries worldwide. Pakistan has already seen major benefits from the BRI, including billions of dollars being deployed in the country. The BRI has already proved

New globalisation – The path to the future

to be a real game-changer for Pakistan – and is further contributing to the strength of the relationship between China and Pakistan.

As witnessed during my years in office, this has always been our strongest and most enduring friendship. It is driven by peace, harmony, mutual respect and commonality of interests. The relationship has never been directed against another power; it is a model of how bilateral relations could and should be.

A creator, not a destroyer

Questions we need to be asking ourselves today are: What does the future of Asia and the world look like? What will be the main drivers of growth? What will the nature of employment look like in an automated world? And how will increasingly sophisticated technology, robotics and artificial intelligence fit into our society?

The revolution being driven by so-called 'disruptive technology' should be seen not as a threat, but as an opportunity for progress. Technological advances can usher in development and social mobility on a level that has never been seen before.

Technology can bring many positive attributes to our society, including the following:

- It brings us closer to having perfect markets, and transforms how we do business.
- An increasingly interconnected world can break down taboos and cultural barriers, bringing people closer together. It can redress prejudices and provide a better chance of settling conflicts because we will have a greater understanding of people different to ourselves. Our globalised media means something can happen in a far-flung corner of the world and resonate instantly.
- It can improve the delivery of public services, while encouraging greater transparency and therefore more effective governance.
- It is knowledge – and empowerment. The phone in my pocket is not just a phone; it is a teacher, a job provider and a private banker. It has helped transform the lives of billions, and can continue to do so.

Much has been said about the disruptive aspects of technology and the negative repercussions it can bring to established industry. Of course, it can lead to job losses, and all governments should be developing strategies to address this.

It is important to perceive these technological shifts as a creator – not a destroyer – of jobs. The jobs that are disappearing are low-skilled jobs, and we now have the opportunity to forge more interesting, skilled careers.

The technological revolution must be coupled with the provision of the requisite skills training to everybody in society. Our children need to be taught to innovate. While machines can – and will – become more and more sophisticated, they still cannot replicate the human mind, the capacity to invent and to be creative. Rewiring our brains to accept the changes around us and embracing a positive approach – and seeing opportunities, instead of problems – is a vital first step.

If we continue down this path, I believe we will see disruptive technology become a true driver of future global growth. I would argue that new technology makes way for a more democratic form of globalisation. The new opportunities offered by the internet and the new ways of doing business have made it more accessible – and more inclusive – than ever. Anyone can set up and run a business from their personal computer. The way we process and deliver goods is rapidly evolving, and the internet has taken power away from large corporations and put it into the hands of consumers and small businesses.

Harnessing Asia's tremendous potential

As for the future of Asia, no other region in the world has the equivalent potential in terms of strong demographics, which can be harnessed to create an even more vibrant region. Many countries in Asia have a rapidly rising young population with a high capacity for hard work. This presents opportunities and challenges for policy-makers because job creation, infrastructure development, education provision and civil society structures must keep up to provide for the burgeoning youth population across the region.

In development terms, Asia should see a further move to raise living standards and average wages, as well as a more equitable distribution of growth. Improved quality of life should increasingly reach rural and remote areas, and there should be a focus on making growth sustainable.

Only through continuous reform can we stay ahead of the curve. It is the best way to create the absorptive capacity for growth and ensure a prosperous future for all countries. No country – or organisation – is exempt from the need to adapt and reform. Our technological changes make this more relevant than ever before.

Just as our approach to trade and business will need to adapt, so will our values in this modern world. Governments and civil society have a crucial role to play in nurturing in our youth those values that work in the modern world and help foster peace and tolerance. All faiths must learn to live with each other, and we must encourage mutual understanding to promote interfaith harmony. Otherwise we will see prejudices grow – and tensions rise. At worst, this could increase the threat of radicalisation and extremism. One of the main challenges facing us collectively today is migration: a disastrous fallout from the conflicts raging in the Middle East has been the mass displacement of populations and a global refugee crisis.

First, these issues must be approached with a sense of humanity. Any country that builds walls around itself, limits trade and interaction with the outside world and bans visitors or immigrants from other countries or faiths will pay a price for its isolation.

However, the flow of migrants into any country also requires careful handling; borders need to be controlled to minimise security risks. If moderate leaders cannot do this, the situation can play into the hands of far-right parties and extremist groups.

Regrettably, the major powers are splintering and struggling to co-exist harmoniously. The challenges facing Europe – from the rise of populism in countries such as Hungary and the UK's decision to leave the European Union, to the persistent challenge of slow economic growth – are creating greater uncertainty. Once again, it is through establishing connectivity and reasons for working together that we can preserve peace – even when political splits are emerging.

Resolutions for the future

Blocking and tackling will get us nowhere in the long run. A renewed focus on dialogue and engagement is needed – and a greater effort to resolve long-standing issues, including the territorial disputes in Kashmir and Palestine. We also need to identify areas of common interest, such as the global issues of preventing climate change, alleviating poverty and protecting human rights.

What might the future hold? How do we address the increasingly complex global challenges we face?

First and foremost, we must have a renewed focus on education. It is the greatest investment we can make today for our youth and our collective future. It is clear the majority of current curricula do not provide young people with the necessary tools to forge their way in the world of tomorrow. The changing job market and the new skills required in the new economy will create the need for a different approach to how we teach our children. Everybody – from the state to non-governmental organisations and businesses – has a role to play. Focusing on education will secure all our futures, even if this means developing a system that does not resemble today's.

In addition, we must build a new architecture for global trade and co-operation, one that reflects the challenges and needs of the new economy we are moving towards. The foundation of the Asian Infrastructure Investment Bank has been a welcome step forward, and it has already facilitated billions of pounds' worth of projects under the BRI. In addition to developing new structures, however, the existing Bretton Woods Institutions – the World Bank and the International Monetary Fund – also require change. Rather than preach reform, they must examine their own need for improvement and restructuring, and move with the times.

Crucially, we must focus on generating inclusive, equitable growth. The new technological revolution makes this more attainable than before. If handled correctly, and coupled with prudent policy and regulation, technology can help transform our society into one more fair and more peaceful.

It is important to combine structural economic reforms with social sector improvements, boosting literacy rates and providing opportunities to all citizens to empower them and provide them with a better future. I believe change is the only constant – and it is time to accept this and press on.

To successfully steer us through these times of change, we all have one need in common: strategic, long-term leadership. We must develop a new vision of the world, one that will reshape the global economy to make the most of the opportunities we are presented with and that guides us through the challenges. One that will create progress and growth, which is equitable and fair for all.

There needs to be informed discussion of bigger-picture solutions at the highest levels, and how they can be implemented. We need to ask ourselves questions such as: How can we transform our education system quickly enough to keep up with the pace of change? How will we fill the skills gap that exists today? How will we ensure equitable growth that reaches those in poverty today?

Lack of leadership

Regrettably, we do not live in a time where such lessons of leadership are put into practice across the world. We collectively face a leadership deficit. It is time to recognise that we face common challenges that require careful diplomacy and co-operation. No two countries' interests will ever fully align, but it is important to find ways of reducing the shortfall of trust between them and creating an environment that can enable peace.

Unless the gaps between the major powers are bridged, the repercussions of this will be felt for decades to come. Only far-sighted leadership can help bridge the gap between the major powers to build a safer, more prosperous world for us all.

To succeed in the world of tomorrow, we need to have open minds. We need to teach ourselves to embrace change. This change can be technological, economic or social – and will be at a pace faster than ever before. Only if you are able to rise to the occasion, keep your mind flexible and stay ahead of the curve will success be yours.

Top gear – The drive to openness

Idling in neutral, the world economy has the technology for a great leap forward, but the demand is not yet there. *Zheng Zhijie*, president of the China Development Bank (CDB), discusses how China will set the tone for the next phase of globalisation, and maps out the role the CDB can play in deepening reform and high-quality development

Zheng Zhijie

A major new round of developments, transformation and adjustments is unfurling as economic globalisation continues to progress. Economic globalisation is an inevitable consequence of the development of social productive forces and the objective requirements of the flow of capital, commodities, labour and other factors of production. It has injected powerful impetus into world economic growth over the past few decades, causing new landscapes and changes to emerge.

An economy in neutral

The global economy is in transition: traditional growth momentum is insufficiently powered by sluggish demand while the new round of scientific and technological revolution and industrial transformation is positioned for dynamic growth. The shift between driving forces has not yet been completed.

The World Trade Organization (WTO)-based multilateral trading rules are haunted by protectionism, unilateralism and anti-globalisation. Trade disputes have intensified and the global trading system has been severely tested.

New industrial, value and supply chains are increasingly being forged through adjustments in the industrial division of labour, while international competition and co-operation are following new trends.

The spillover effects of monetary policy in major economies are becoming more pronounced. Large-scale capital flows could lead to financial market turmoil, slowing long-term economic growth.

In governance, relative international economic strengths have evolved, with emerging markets and developing countries accounting for around 80% of the world's economic growth. Reform of the governance system and the international order is gaining speed. In the face of these economic twists and turns, only by strengthening openness and co-operation and working together to cope with risks and challenges can the world achieve mutual benefit and common development.

China champions economic globalisation and has made important contributions to building an open world economy. In the past 40 years of its reform and policy of 'opening-up', China has continuously enhanced co-operation with 'wide-open door' policy and has sought common development – from actively 'bringing in' and 'going global', to the Belt and Road Initiative (BRI), which aims to promote connectivity in policy, infrastructure, trade, finance and interpersonal exchanges.

When China joined the WTO in 2001, the nation was a novice at following international economic and trade rules. Today China is an active proponent of global governance, boosting trade and investment liberalisation and facilitation, and advocating a community with a shared future for mankind. China's pace of opening-up has never ceased, and its openness benefits the rest of the world. Today, China is the world's second-largest economy, the biggest trader of goods, and a major trading partner of more than 130 countries. It's GDP per capita exceeded US$8,800 in 2017, leapfrogging it from a low- to middle-income country. China has contributed more than 30% to world economic growth for many years, acting as the major stabiliser of the global economy, an important driving force for economic globalisation and an active contributor to global governance reform.

Standing at the crossroads of history, China will conform to the trend of globalisation and continue to advocate for high-quality development, which has now supplanted high-speed growth as the economy's primary model. This transformation is optimising the economic structure and transitioning growth momentum. At this important juncture, it is necessary to take the following aspects into consideration to adapt to the new trends of globalisation and build an upgraded version of the Chinese economy:

1. Ensuring a more open economy, further expanding opening-up and creating a more comprehensive, deeper and more diversified opening pattern in the face of deep-seated contradictions and bottlenecks in development.

2. Continuing to follow the path of innovation-driven development. With the decline of the traditional advantage of low-cost goods, it is necessary to further enhance research and development capabilities, increase total factor productivity and convert economic growth dominated by resource and capital investment into one relying on independent innovation and domestic demand expansion.

3. Establishing market laws, easing market access, reducing market failures and costs for trial and error, and ensuring the market plays a decisive role in resource allocation.

4. Gradually narrowing the income gap between urban and rural areas and among regions, providing more support for the rural areas in the central and western regions of China, and improving the wellbeing of the population.

5. Encouraging the diversified development of finance, deepening the reform of the investment and financing system, improving financial ecology, establishing a co-operative system of diversified financial development, reducing the financing costs of the real economy, and preventing systemic financial risks.

The China Development Bank (CDB) will continue to play a significant role in serving China's high-quality economic development while ameliorating economic globalisation. As a state-owned development financial institution, the CDB has for many years been an indispensable financial power in socioeconomic development, serving the national strategy and vigorously supporting infrastructure, basic sectors and pillar industries, people's livelihoods, science and technology, environmental protection and other social services.

Meanwhile, the CDB has worked closely with international governments and organisations to serve the BRI and has actively engaged in global financial governance by initiating the Shanghai Cooperation Organisation Interbank Consortium, the China–ASEAN (Association of Southeast Asian Nations) Interbank Consortium, the Brics (Brazil, Russia, India, China and South Africa) Interbank Cooperation Mechanism, the China–Central and Eastern Europe Interbank Consortium, the China–Arab States Interbank Consortium and the China–Africa Financial Cooperation Interbank Consortium. The CDB assumes responsibility for enhancing multilateral financial co-operation and advancing China's participation in globalisation in broader ways and at a higher level.

The Shanghai highway network

Future gazing

The CDB will continue to develop its strengths as a financial bank, and will become a world-class financial development institution and an active power in globalisation. Domestically, the CDB will continue to push forward the construction of a modern economic system and, in accordance with the requirements of high-quality development, the CDB will deepen supply-side structure reform and promote the development of cutting-edge fields such as IT, intelligent manufacturing and green energy to drive change in the quality, efficiency and power of economic development.

Globally, the CDB will support the development of the BRI to build a community with a shared vision and future for mankind. With the concept of mutual benefit and a win-win outcome in mind, the CDB will support the BRI's key areas and projects in a market-oriented manner to enhance the livelihood of people in countries along the route, and help establish a new level of openness to the outside world. Continued efforts need to be made to deepen co-operation with financial institutions worldwide and forge synergy to provide long-term, stable, sustainable and risk-controllable financial support for economic development. The CDB stands ready with all parties to advance openness and co-operation and make new and positive contributions to the shared development of an open and innovative world economy.

About IFF

The International Finance Forum (IFF) is an independent, non-profit, non-governmental international organisation, founded in Beijing in October 2003, initiated by more than 20 primary international organisations, such as the UN, and a significant number of financial institutions and leaders. The IFF is a long-standing high-level platform for dialogue and communications, and a research network in the financial realm. The IFF aims to develop and encourage financial think tanks within China and other emerging economies, and has been upgraded to F20 (Finance 20) status.

Our Mission

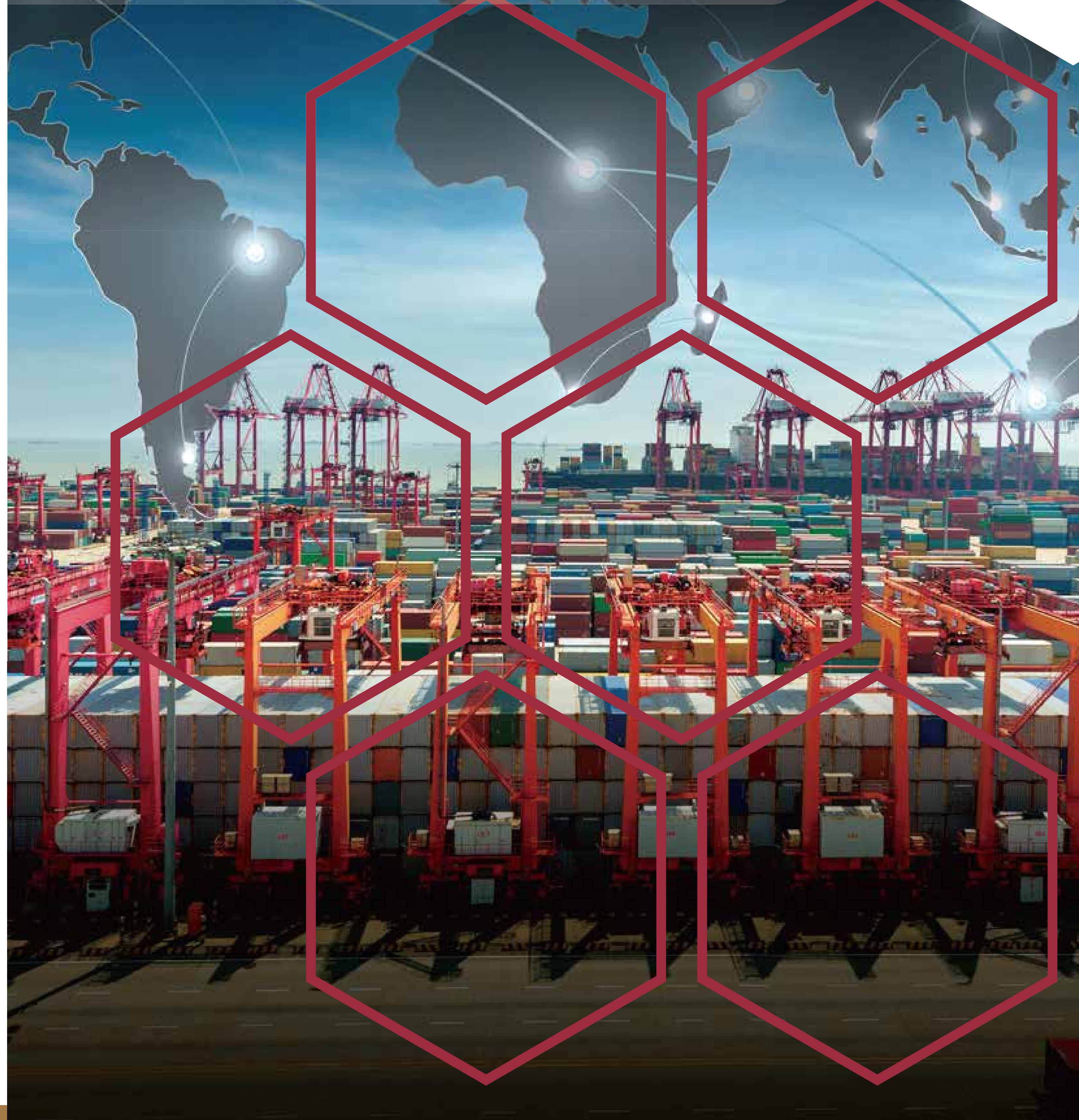
Following the spirit of "Comprehensive and Sustainable Development —New Capital, New Value, New World" since the founding in 2003, IFF is committed to building itself into a world-class academic think tank and multilateral dialogue platform with strategic insight.

Our Goals

IFF operates based on an open, transparent and fair mechanism to ensure its independence, objectivity, foresight and inclusiveness, and to facilitate global financial operation and exchanges. Through in-depth research on global finance, IFF is committed to promoting the sustainable development of China and the world economy. Our targets include:

1. International Financial Strategic Dialogue Platform
2. International Financial Co-operation & Exchange Platform
3. International Financial Innovation & Practice Platform
4. International Financial Strategic Think Tank Platform
5. International Financial Talents Platform

REDESIGNING THE INTERNATIONAL TRADING AND MONETARY SYSTEM



Redesigning the international
trading and monetary system

An international system for all

Reform of the system that brought about the financial crisis in 2007–08 has not gone far enough, writes *Zhu Xian*, IFF vice-chairman and vice-president of the New Development Bank. Developing countries are demanding greater influence in global economic governance to promote infrastructure growth and stimulate further globalisation

Zhu Xian

The global economy is undergoing profound change. Declining growth momentum, a widening wealth gap, global political conflicts, volatile financial markets and rising trade protectionism have derailed globalisation efforts. Major advanced economies remain trapped in cyclical economic crises. As the world's major central banks gradually tighten monetary policy, debt will continue to grow rapidly, and the risk of another economic downturn is emerging.

Many developing countries are using trial and error to seek out sustainable economic development. Given the different political and economic landscapes in these countries, no single model can secure successful sustainable growth. As a result, many developing countries are exploring and experimenting with different policies in line with their own domestic frameworks.

Meanwhile, many have not been able to shake off periodic volatility of the US dollar. Since April 2018, as the dollar index has risen beyond all expectations, countries including Argentina, Turkey and Brazil have experienced financial turmoil, and asset prices have sharply adjusted.

Echoes of the financial crisis

A decade on from the 2007–08 financial crisis, the smoking gun is now believed to have been an imbalance in the global financial system. Excessive debt leverage, 'too big to fail' financial institutions and shadow banking were to blame. However, over the past decade, there has been no fundamental change to mitigate recurrence of these issues.

According to the Institute of International Finance, global debt climbed to a new peak of US$247 trillion in the first quarter of 2018, equivalent to 318% of global GDP.[1] The top five US banks now control 47% of US bank assets, compared with 44% in 2014, with the largest 1% of mutual funds managing 45% of assets.[2] The value of the shadow banking industry, meanwhile, has grown to $45 trillion ($28 trillion in 2010), controlling 13% of the world's financial assets.[3] Regulatory pressure on banks appears to have only created more room to grow for the shadow banks.

Governance reform

The US has transformed from being a leader and defender of multilateralism and free trade, to a cheerleader for the bilateral principle of "America First" in trade and investment. President Donald Trump's waving of a protectionist stick has brought increasing uncertainty to economic globalisation.

Technology is pushing back against this new trend. The development of intelligent manufacturing, the digital economy and the widespread use of renewable energy has led to profound change in global value chains. The traditional impetus for globalisation has been diminishing; it is now urgent we find new stimuli.

In a keynote speech at the Asia-Pacific Economic Cooperation Leaders' Meeting in November 2018, President Xi Jinping indicated we should improve global governance. The existing international multilateral financial system, established after World War II, is rules-oriented and far from perfect.

Progression remains the priority of developing economies and the solution to social and economic problems, including poverty and uneven income distribution. Developed countries focus more on macro policy and public governance. Advanced economies generally have a greater influence over the international multilateral financial system, and yet it is the developing countries that need their say the most.

For reform to be successful, it must be endorsed by all. There is a strong case for reform of the international system, including the World Bank and the International Monetary Fund, but the direction of such reform is uncertain.

Emerging markets and developing countries have underlined the shortcomings of these multilateral institutions for many years and have demanded more decision-making power. The demands in emerging markets and countries at various stages of development are not aligned with each other, let alone with advanced economies. Some developing economies are good at destroying an established order, but not yet proficient in building a new one.

In the future, multilateral financial institutions will have an important role to play in helping member countries carry out countercyclical regulation, temper expectations and boost market confidence through infrastructure investment and other methods. In 2015 and 2016, the Asian Infrastructure Investment Bank (AIIB) and the New Development Bank (NDB) were established.

The two banks are complementary to the existing global multilateral financial system by financing large global infrastructure. In the spirit of openness, inclusiveness and win-win co-operation, the AIIB and the NDB have established close partnerships with existing multilateral development banks, bilateral development agencies and the private sector to explore a variety of business models, including government and social capital co-operation and joint financing, so as to jointly improve the level of infrastructure investment and financing in developing countries and promote sustainable development and global economic recovery.

1. *A Tanzi, Bloomberg,* Global debt topped $247 trillion in the first quarter, IIF says, *July 2018, https://bloom.bg/2BoNTGh*
2. *S Schaefer,* Forbes, *Five biggest US banks control nearly half industry's $15 trillion in assets, December 2014, https://bit.ly/2WIUYun*
3. *C Binham,* Financial Times, *Shadow banking grows to more than $45tn assets globally, March 2018, https://bit.ly/2TVb9n0*

The EU and China – A frank-talking friendship

José Manuel Durão Barroso, IFF co-chairman, former president of the European Commission, and former prime minister and foreign minister of Portugal, takes a personal look at four decades of working in a spirit of openness and co-operation with China

I was Portugal's foreign minister between 1992 and 1995 – a crucial period of negotiation in Macao's transfer of sovereignty to China – during which time I became more deeply involved in relations with China. I have been visiting China since the 1980s, and have seen its remarkable development and modernisation. As prime minister of Portugal and president of the European Commission (EC), I took part in an expansion in dialogue and co-operation between the European Union and China.

The *EU-China 2020 Strategic Agenda for Co-operation* was adopted in 2013, during my time at the EC. The EU and China now participate in structured co-operation. The EU has had diplomatic relations with China since 1975, and these relations now cover more than 70 high- and senior-level sectoral dialogues. This long-standing co-operation between the EU and China is a wide-ranging, strategic dialogue covering issues of great importance.

July 2018 marked the 20th EU-China summit, meetings attended at the highest level on both sides – usually the premier of China and the presidents of the EC and European Council.

I was involved in the talks not only with my colleagues, such as the premier of China, Li Keqiang, but also with former president Hu Jintao and President Xi Jinping, who paid his first-ever official visit to the EU institutions in Brussels as president in 2014.

Economic relations are extremely important: the EU is China's largest trading partner, and China is the EU's second largest after the US. The trade in goods between the EU and China exceeds €1.5 billion a day, and will soon approach €2 billion. It is valuable not just because of its volume but because of its scope: the trade covers multiple areas and the goods traded are already part of integrated supply chains.

Unfortunately, some still think in the old terms of trade: one country produces something and sells it to another. Today, what happens often is that one country exports some components to another country that are later returned.

These supply chains between the EU and China are becoming increasingly integrated. Official EU figures reveal that in 2017 the EU exported €198 billion in goods to China, and has imported €375 billion in goods from China.[1] There is therefore a surplus on China's side; but in services there was a small surplus on the EU's side in 2016: it exported €38 billion in services and imported €30 billion worth from China.[1]

José Manuel Durão Barroso

Unlocking investment opportunities

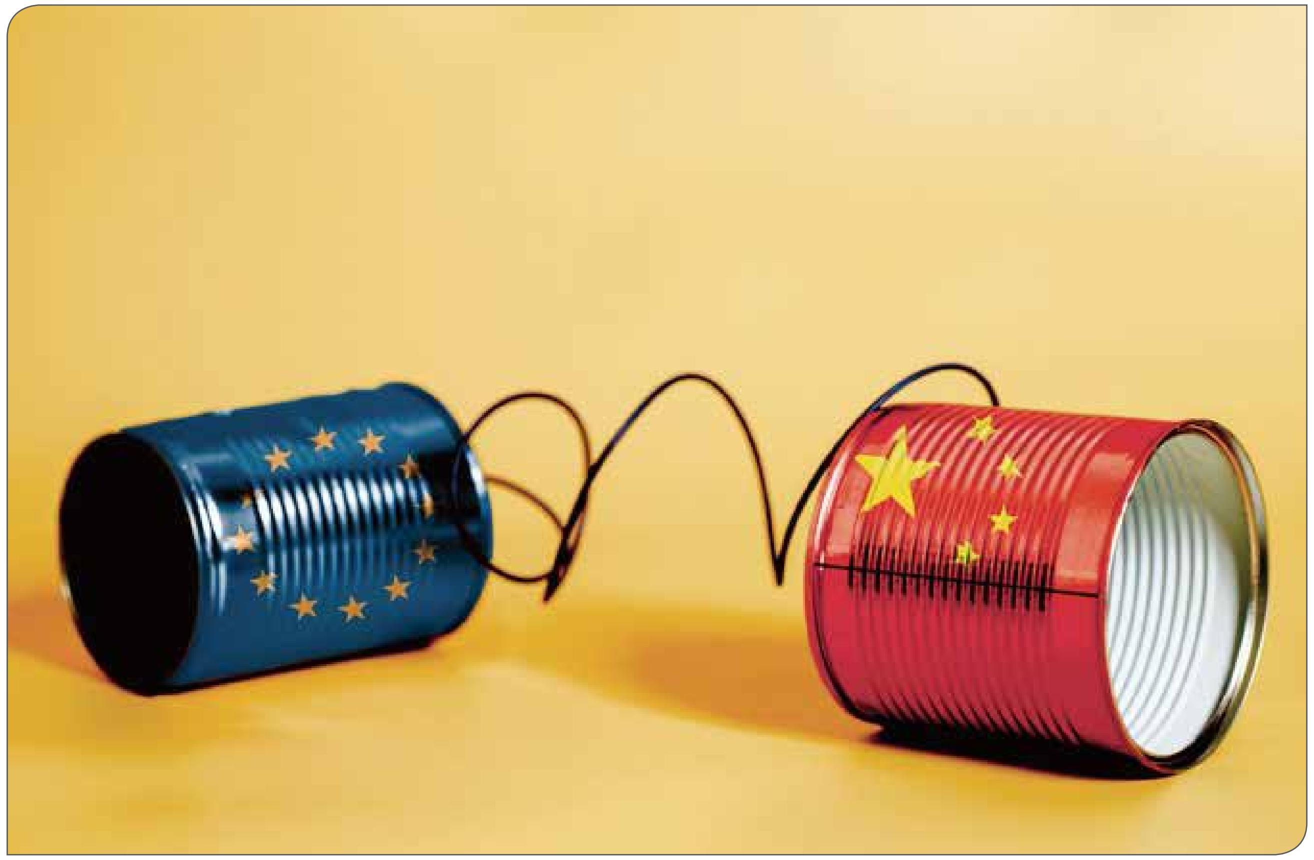
Clearly, this is an important and substantive economic and trade relationship. Today, the EU is negotiating with China a comprehensive agreement on investment. As president of the EC when this matter was discussed, we took the decision to launch negotiations in 2013. We had initially been discussing the possibility of a free-trade agreement (FTA) with China. However, there was no consensus for one within the EU. The difficult issues of the differing structures of our economies, as well as the recognition of the so-called market economy status of China, were discussed continually by the EU and the leadership of China. It was eventually decided that, instead of opting immediately for an FTA, we should first work for a comprehensive agreement on investment, because this agreement would create a level playing field for business, increased market access and liberalisation, and therefore new opportunities for both sides.

From a European perspective, the idea was also to support China's economic reform. Last year, China commemorated 40 years of its policy of 'opening-up' and reform, of which the EU has been very supportive.

One issue of great importance from a European perspective is the access of foreign direct investment. A concrete example can be found in Portugal, where the most important electricity company is now controlled by a Chinese company, the most important electrical grid is controlled by another Chinese company and the most important private bank is controlled by a Chinese group, as are the most important insurance company and one of the country's leading private hospitals.

It is evident Portugal is extremely open to foreign economic investment. That electricity company is the most important utility in Portugal, and when the Portuguese government opened a tender, it took a bid each from a Chinese, a Brazilian and a German company. From those three bids, the Chinese offered the best price and won the tender. Would it be possible the other way around – for a European company to take control of a Chinese utility? Frankly, no. Even today, as announcements are made about reinforcing opening-up, the reality is this is not yet possible in the Chinese financial sector. So authorities in China and the Chinese people must make a very important decision: are they ready to accept that level playing field in terms of direct investment? If so, China can remove an important obstacle between trade among different countries and defuse some of the arguments made by those who want to create tension: that China does not operate on a level playing field, as well as arguments such as those concerning industrial policy, intellectual property rights and others.

It is in China's interests to grant more direct access to investment if we believe our economies should be more integrated. That integration will come about not only through the traditional mechanisms of trade or tariffs and quotas, but through direct investment and the rule of law to protect investors on both sides.



New consensus in Europe

The EU does not wish to simply tell others how to do this, but to share its experience. The EU – originally the European Community – was created after World War II to apply economic integration and eliminate the possibility of another war between European nations. Since then, in western Europe there has been no war.

In Europe today, a war between EU member states is inconceivable. These are centuries-old, long-standing, independent sovereign nations that decided to create this mechanism of integration, not only with the common market, but also by abolishing all types of friction – quotas and tariffs – in trade between members. A small company from Portugal can sell to Germany without any kind of obstacle and vice versa, aided by the customs union and the integrated supranational measures for the countries of Europe, including a single currency in use by 19 member states. This is the most advanced case ever of integration in regional terms.

There are similar manifestations of integration elsewhere – such as the Association of Southeast Asian Nations – but, in terms of supranationalism, there have never been such high levels of integration, commercial investment and monetary policy, concerned with redistribution policies that allocate large sums to the poorest regions, as in the EU.

I do not suggest the same model should be applied worldwide, but it is important to recognise that European countries have the experience of removing barriers and setting a level playing field to encourage common investment and to facilitate trade.

1. European Commission, correct as of April 2018, https://bit.ly/2rjDZRw

Unstoppable integration

The EU has proved its resilience: between 2004 and 2014, membership of the EU almost doubled – from 15 states to 28. Most of these new members had been part of the Eastern bloc under the control of the Soviet Union: Poland, Hungary, Czech Republic, Slovakia, Romania and Bulgaria. The three Baltic states – Latvia, Lithuania and Estonia – had been part of the Soviet Union itself and countries that had been part of the former Yugoslavia, such as Slovenia and Croatia, also joined.

At the time of writing, the UK is set to secede from the EU this year, reducing the number of member states to 27, but other countries want to join the EU. Even during the most acute financial crisis since the beginning of European integration in the 1950s, it was possible for EU membership to increase from 15 to 28 members and establish even more mechanisms for integration. For instance, it is not yet complete, but today we have a banking union with a single supervisory mechanism for the banks created precisely to respond to the crisis. Sometimes it takes these crises for the EU to increase its integration because only under pressure are national leaders ready to make compromises and to advance with integration.

I remember the Group of 20 summit at the time of a possible 'Grexit' – when many of our partners thought Greece's exit from the EU was unavoidable, and that the euro would collapse. Nothing of the sort happened. On the contrary, new instruments were introduced, such as the European Stability Mechanism, a kind of European monetary fund that is still developing and being reinforced. We kept Greece in the eurozone, and today the euro is the second most traded global currency thanks to the resilience of the EU and the currency itself.

During the Greek crisis, China supported the EU and the euro when many market participants expressed deep mistrust in it and were selling its bonds. China understood strategically that the euro would most likely remain an important currency, and it made sense to indicate to the world the importance of the EU.

Of course, not everything is perfect between China and the EU. Problems existed and continue to exist in terms of trade, but we treat these problems in a discrete manner – trying to prevent them contaminating relations elsewhere and leading to additional areas of conflict.

In international diplomacy, it is important to avoid overdramatisation, which only creates more problems for the future. Countries, like people, have feelings, frustrations and a sense of pride. International policy should never be based on a sentiment of arrogance; all forms of arrogance are a form of stupidity. Creating resentment should be avoided.

Of course there is still more to be done, but some of these areas require further convergence, keeping in mind the strategic purpose of the relationship, which is to maintain a good relationship between China and the EU.

China's growth is an opportunity for global expansion and prosperity. The EU admires China's achievement of lifting hundreds of millions of people out of poverty, an admiration it has expressed privately and publicly to the Chinese leadership. In turn, the Chinese leadership has expressed its great respect for how Europe was able to truly reconcile former enemies.

In Asia today, that kind of reconciliation, after the terrible conflicts of the past, has not yet occurred. But reconciliation will be very important for the future because it has a far-reaching economic impact.

China understood strategically that the euro would most likely remain an important currency, and it made sense to indicate to the world the importance of the EU

Clouds on the horizon

The global economy has been performing well because of a situation where all the main powers at all the main poles of economic development have been growing. We have seen spectacular growth in the US, to a large extent stimulated by tax reforms made by the current administration, far greater than in Europe. Nevertheless, no country in the EU is in recession and there is moderate growth, in some cases above expectations: quite an achievement for such mature economies. China remains a driver of global growth, Japan has been growing and so have most emerging economies.

Some clouds have appeared on the horizon, however, and we see some forthcoming issues in emerging economies. We believe the US will not be able to sustain its current level of growth, and there is also the possibility of a slowdown in Chinese growth. If trade frictions continue, that is likely to happen, and this year will be a great test of resilience for the Chinese economy.

China must solve the crucial dilemma of how to sustain growth without creating further debt. Levels of debt in China have been growing more than the leadership would like to see. The European analysis of China is that the key for China to maintain growth and drive long-term prosperity lies in structural reforms and its commitment to push on with market-based reforms.

President Xi has personally committed to the reforms because their ability to increase productivity will be able to compensate for any negative news as a result of a backlash in terms of trade or international investment. It's unavoidable that this year will see more market and economic volatility.

That is another reason the EU and China should continue to work together in a spirit of openness, frankness and friendship, keeping in mind the overall goals of our strategic relationship and protecting the interests not only of our own citizens, but of the world. It can only be beneficial to the global economy that the EU and China continue to co-operate and achieve a greater degree of convergence around their objectives.

After the storm

A decade after the financial crisis, *Li Yang*, director of the National Institution for Finance and Development, looks at shadow banking and central bank priorities, and how a new global order and new rules emerged from the wreckage

In the wake of the 2007–08 crisis, the world's financial structure underwent significant adjustments. The balance sheets of commercial banks have improved, despite many firms bearing the brunt of the financial crisis during those first years of recovery. Losses were great, and a number of major commercial banks were shuttered. In Europe and the US, some firms were nationalised. But, following more than a decade of change, commercial banks have started to evolve once again.

One result of this recovery has been an expansion of capital markets. As banks refine and reduce their balance sheets and deal with non-performing assets, the share of the capital market as a proportion of the entire economy has grown remarkably. Accordingly, some countries have raised the ratio on the amount of fundraising activities that can take place in the market – although China is yet to do so.

Meanwhile, shadow banking – the importance of which was highlighted in the initial phases of the financial crisis – continues to develop. Shadow banking causes disruption to the wider financial system and, in the wake of the crisis, financial authorities attempted to regulate the sector.

The market has also become more concentrated since the crash. The dominance of the top five banks and insurance companies – those with healthy balance sheets in 2008 – has continued because many of the smaller financial institutions were unable to endure the recovery period and were either merged, acquired or went bust.

Li Yang

There are obviously other factors at play, but those discussed have had a more prominent structural impact within the financial services industry.

On the monetary side, inflation has remained low. The top priority of most central banks is to maintain price stability; between 1995 and 2004, many of them implemented counter-inflationary measures to stabilise prices. After 2004, prices began to fall.

As the economy continues to recover, changes are expected in the balance of payments. China currently has a large trade surplus while the US is running a trade deficit – a situation that requires recalibrating. A decade on from the crisis, the current account imbalance is narrowing at a global level. But, simultaneously, capital flows are changing and in some countries even reversing. It is foreseen that a new international pattern within the balance of payments will emerge in the near future, when financial factors may be more important than real economic indicators.

By far the greatest monetary factor to consider in the coming years will be the divergence in monetary policy. Following the financial crisis, interest rates worldwide were slashed by the world's central banks, and they have remained low during the recovery period. Global real interest rates have plunged from about 5% in 2004, and for a time the rate remained negative. Monetary policy, as a result, diverged and in some parts of the world turned negative. It is now believed that real interest rates are lower than estimated by many central banks.

The US Federal Reserve has begun to normalise its policy stance. However, Fed chairman Jerome Powell expects no rate rises in 2019, largely as a result of sluggish global growth. The Fed has also indicated it will end the shrinking of its balance sheet in September 2019.

The import of these changes is yet to be fully realised; the world is changing rapidly, and financial institutions and regulators must keep pace. It is impossible to predict the future, and we must view the world with an ever-evolving mindset attuned to its permanent evolution. We must formulate new policies based on new practices.

Internationalising renminbi – Hong Kong leads the way

Hong Kong's advantages in technology, talent and infrastructure make it best placed to form the primary transaction and risk management network for the overseas offshore renminbi market, argues *Zhou Chengjun*, IFF Academic Committee member and deputy director of the Research Institute at the People's Bank of China

As part of the global financial hub in the Guangdong–Hong Kong–Macao Greater Bay Area, Hong Kong has a key role to play in boosting the internationalisation of the renminbi. Its offshore renminbi market will gain stronger support from its inclusion in the Greater Bay Area.

The earlier format of renminbi internationalisation was made possible because of China's strong position as the country with the world's second-largest GDP and as the world's largest trader of goods. China evolved the function of renminbi payment and settlement in international trade, and many overseas investors began to choose to hold renminbi for two reasons: the renminbi was widely used for settlement in international trade, and it was appreciating in value.

The renminbi's value soared by 36% between 2005 and 2014, when the trend ended with a depreciation of around 2.5%. However, RMB adoption across financial institutions worldwide rose from 18% to 36% between 2013 and 2016.

Zhou Chengjun

Why did the international market still invest in renminbi holdings despite the threat of devaluation? The answer lies in the nature of the renminbi, which has evolved from a trade settlement currency to an international investment and official reserve currency, marked by its inclusion in the special drawing rights (SDR) basket. China's financial market has been open to foreign investors since 2015 via multiple channels, encouraging foreign investors to hold renminbi assets.

For non-resident investors, holding renminbi represents entry into a new market with a new currency. When rational investors invest in renminbi asset holdings, they are expecting to use risk management tools for duration matching and liquidity transformation, in addition to the management of exchange rate risks.

Following entry into SDR, the next target of renminbi internationalisation is to become an international financial transaction currency or foreign exchange market currency, rather than merely an international trade settlement currency or investment reserve currency, in a bid to form a complete asset trading chain covering trade settlement, reserve investment and risk management.

To attain this goal, a renminbi offshore asset market, exchange trading market and international financial trading market are needed. These are three fundamental features not currently underpinned by trade and foreign direct investment or high-frequency and large-scale trading activities. For this reason, the market should, by its nature, be an international renminbi asset forex market.

Functionally, it primarily helps micro-market entities manage the risks of holding renminbi assets, including currency mismatch risks, liquidity management, credit risks, and so on. With such a sound renminbi currency market, asset market and forex market assisting them to resolve liquidity, risks and asset allocation, investors can adjust their expectations, convert their assets and sell off their funds through this market.

Second, to be able to meet the needs of investors, the macro-market must be populated with active transactions, abundant liquidity and market-based prices, and it must be able to effectively balance. The market-based pricing of the renminbi exchange rate can be achieved through such an offshore market, and with the market mechanism to establish where the so-called reasonable equilibrium level of the renminbi exchange rate should be. With the cross-border or continuous liberalisation of capital projects and financial accounts, freer capital market movement should result, where the exchange rate remains fully market-oriented and flexible, reflecting supply and demand.

Redesigning the international
trading and monetary system

Going green

The offshore renminbi market should be green. China is already at the cutting edge in the global green financial market, even emerging as the formulator of green financial standards. Efforts should be made to take advantage of the technological advantages and talent in Hong Kong, and ensure that renminbi assets maintain a green foundation. If enterprise and market entities are encouraged to implement environmental, social and governance (ESG) principles in every Belt and Road Initiative (BRI) investment – respect the environment, be socially responsible and insist on good corporate governance – the international community will show more understanding and acceptance towards the BRI. These investments will, therefore, better help BRI countries achieve sustainable and green development.

Hong Kong is already currently home to the best offshore renminbi infrastructure in the world, which will eventually be able to support the offshore market. Hong Kong's offshore renminbi market has been very successful with real-time gross settlement and is already outpacing the mainland. Foreign non-resident investors hold renminbi either in deposits or assets. Overseas funds are liquidated on the mainland because they are issued by the People's Bank of China, and mainland China retains the right of final issuance and holding of all offshore renminbi assets because all must be supported by the mainland's real economy. On this basis, other overseas financial assets investors can enjoy the benefits of the Chinese market. How can foreign residents hold these assets if all the issuance of renminbi takes place on the mainland? Opening capital accounts and asset accounts are two possible approaches. Nominal holding is made possible in capital accounts while asset accounts are not yet available. Chinese law requires large numbers of foreign non-residents to open real-name accounts in the trustee agency to invest in China's bonds and stocks, the so-called 'penetrating management'.

It is, however, very costly and unrealistic to ask overseas non-residents with renminbi investment holdings to open an account in China. Therefore, it is necessary to consider multilevel custody and nominal holding, as in the case of deposit accounts, to facilitate an asset deposit management system for foreign investors with relatively complete property rights overseas, including in Hong Kong.

Based on these asset accounts, various derivatives transactions, liquidity management and risk management can be carried out to form a better transaction structure and risk management system for the overseas renminbi offshore market. In this field, Hong Kong, as part of the Greater Bay Area, is best placed to move to the forefront.

Playing fair – Unlocking the horns of China and the US

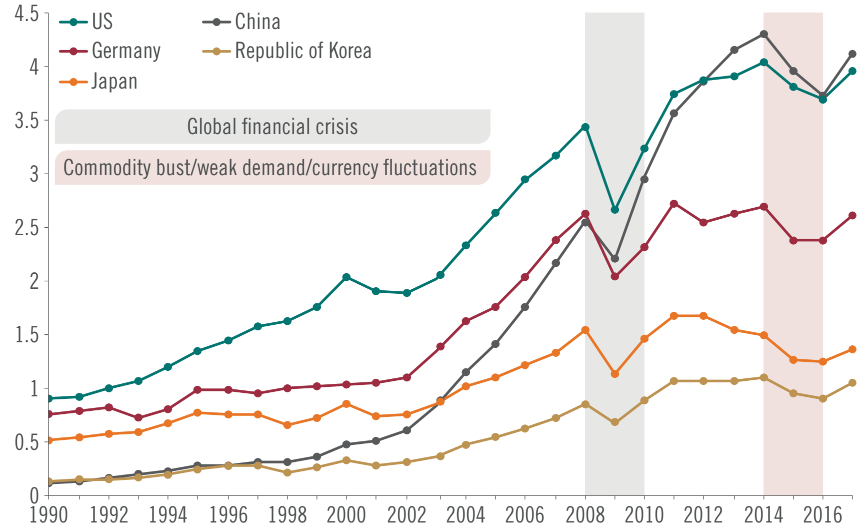
Nicholas Hope, IFF Academic Committee member, former director of the Stanford Center for International Development, and former director of the China programme of the World Bank, discusses the trade standoff between China and the US, and suggests more two-way investment flows could help thaw relations

The unprecedented explosion of global prosperity in the 70 years since the end of World War II owes much to the continuing liberalisation of international commercial activities that has fostered ever-closer integration of national economies into the global economy.

The primary inspiration for the creation of a global economic community – spurred by eight rounds of trade liberalisation under the General Agreement on Tariffs and Trade, and associated reductions in the barriers to international flows – has been the US. Undoubtedly, the US has been a major beneficiary of the system it has worked assiduously to create, but virtually every country – not least China – has benefited in equal or greater measure.

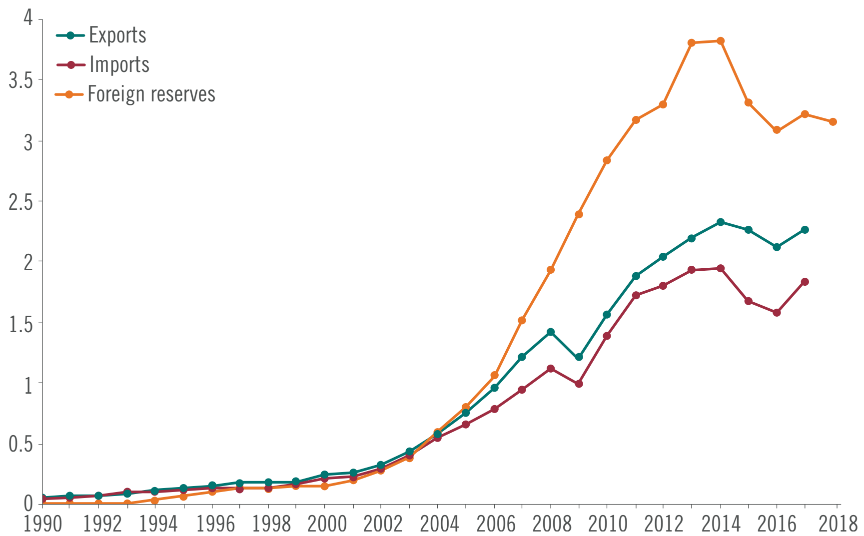
It is with dismay and deep concern that I view the current situation, in which the US administration appears to have determined the arrangements for international commerce are unfair to the US. To redress what is perceived as an imbalance of benefits from trade, the US has discarded its prior commitment to inclusive negotiations to effect freer trade in favour of crude protectionism designed to advance efforts to negotiate favourable bilateral deals.

Figure 1 – Merchandise trade (imports + exports) (US$ trillions)



Source: IMF

Figure 2 – Merchandise trade and foreign reserves in China (US$ trillions)



Sources: IMF; State Administration of Foreign Exchange, China

The US has abandoned the proposed Trans-Pacific Partnership; rejected the North American Free Trade Agreement, which has been relabelled with minor changes as the United States–Mexico–Canada Agreement; withdrawn its support from the World Trade Organization (WTO); and unilaterally imposed tariffs on imports from long-term allies and trading partners.

While all of this has been unfolding, President Xi Jinping has emerged as the champion of continuing globalisation; he and other senior leaders have promoted regional trade agreements and the Belt and Road Initiative, and repeatedly assured other countries of China's commitment to further 'opening-up'. Actions are yet to match the promises that have been made, but recent statements – made at the China International Import Expo, and by the Association of Southeast Asian Nations and Asia-Pacific Economic Cooperation – could presage important breakthroughs to come.

Escaping the impasse

One concern for an outside observer is to identify a way out of the current trade dispute between the world's two largest trading powers – China and the US (see figures 1 and 2).

The ultimate objectives of the US actions are unclear; how will we know that the US is satisfied with the resolution, however it is reached?

Concerns the US has about China include:

- China's bilateral trade surplus – possibly a result of currency manipulation (see figure 3).
- A lack of access to Chinese markets for goods, services and investment opportunities. In addition, US companies face onerous conditions for investment in China: ownership restrictions, and restricted access to technology and intellectual property. The issue here seems to be asymmetric treatment.

- Theft of intellectual property, including state-sponsored attempts to steal commercial secrets. Attention was paid recently to perceived efforts to acquire information about the latest advances in information technology.
- The favoured position enjoyed by Chinese state-owned enterprises that precludes fair competition.
- The objectives of 'Made in China 2025' – China's industrial policy to upgrade the quality of products and services in manufacturing by 2025.

Objective assessment would acknowledge the US has legitimate grievances in these areas, but surely alternative approaches should be preferred to resolve them. The Trump administration's heavy-handed trade policies seem as misguided as they are uninformed.

What is most worrying is that the US will not be satisfied until China eliminates, or significantly reduces, its bilateral surplus – a peculiar obsession of President Donald Trump – and abandons, or modifies in unspecified ways, the goals of Made in China 2025.

China could probably reduce its surplus with the US by opening up further to US products – a process that would be boosted by US willingness to sell what China wants to buy. But, unless the US adjusts its domestic investment to align more closely to domestic savings, any reduction in China's surplus will emerge as an increase in the surpluses – or reduction in deficits – of other countries with the US.

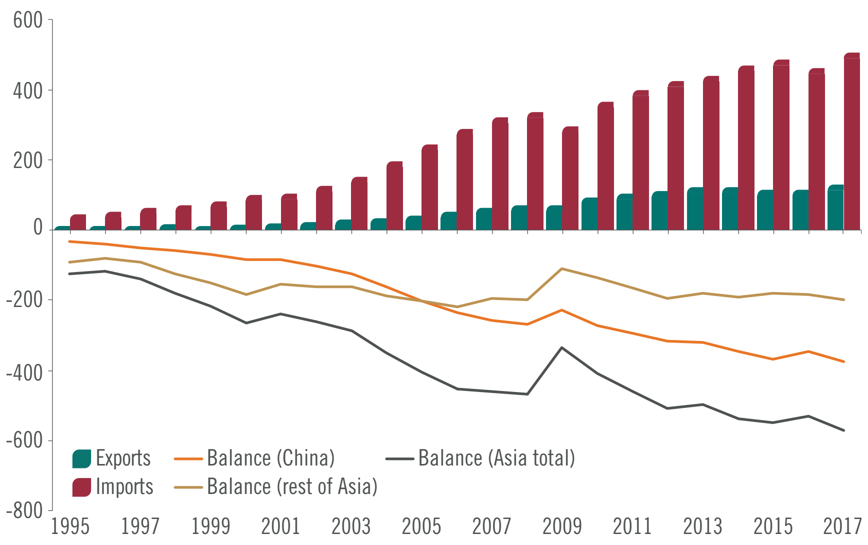
The second obstacle is potentially insoluble: China is unlikely to abandon its longer-term economic goals just because they annoy the US. Not enough is known about what China intends to even endorse the proposed policies for Made in China 2025.

Beyond the damage done by the current trade standoff, prospects for substantially expanded investment flows between the US to China that were encouraged by negotiations towards a bilateral investment treaty (BIT) now seem remote. Volumes of direct investment that the world's largest economies have made in each other are almost unbelievably small compared with their similar investments elsewhere; the interests of both countries would be well served by a major increase in two-way investment flows. China talks about opening up to more foreign direct investment (FDI), but without necessarily including US companies. Meanwhile, the Committee on Foreign Investment in the US is considering an expanded mandate to restrict foreign investment that is deemed a risk to national security.

In this difficult environment, a wise path for China is to continue active support for global economic integration, including by continuing to open up – if possible, more aggressively. Ideally, China could:

- Keep the door open to the US on trade issues.
- Support the WTO and refer disputes to it for arbitration.
- Foster regional trade agreements, but seek inclusive agreements where possible.

Figure 3 – US-China merchandise trade balance (US$ billions)



Source: US Census Bureau

Nicholas Hope

- Continue to allow markets to determine the renminbi exchange rate.
- Seek supply deals with non-US sources.
- Continue – more determinedly – to open the domestic economy to FDI where some promises are unfulfilled: sectors would include finance, energy and communications.
- Pursue the prospect of a BIT with the European Union and others. But extend concessions made to US firms as well – a conciliatory gesture to the US, but very much in China's own interests.

The turmoil test for emerging and advanced economies

Greater integration between advanced and emerging market economies during globalisation has made both more susceptible to risk of spillover – financial contagion and volatility. As the US continues to normalise its monetary policy, deputy governor of Banco de México *Javier Guzmán Calafell* asks if a more co-operative way forward can be found

A period of strong non-resident portfolio capital inflows to emerging market economies (EMEs) in 2017 and early 2018 started to reverse in April 2018, with bond and equity fund withdrawals totalling around US$28 billion to date (see figure 1). This about-face was a response to a spike in risk aversion, reflected in a series of waves of uncertainty over the year around a combination of developments.

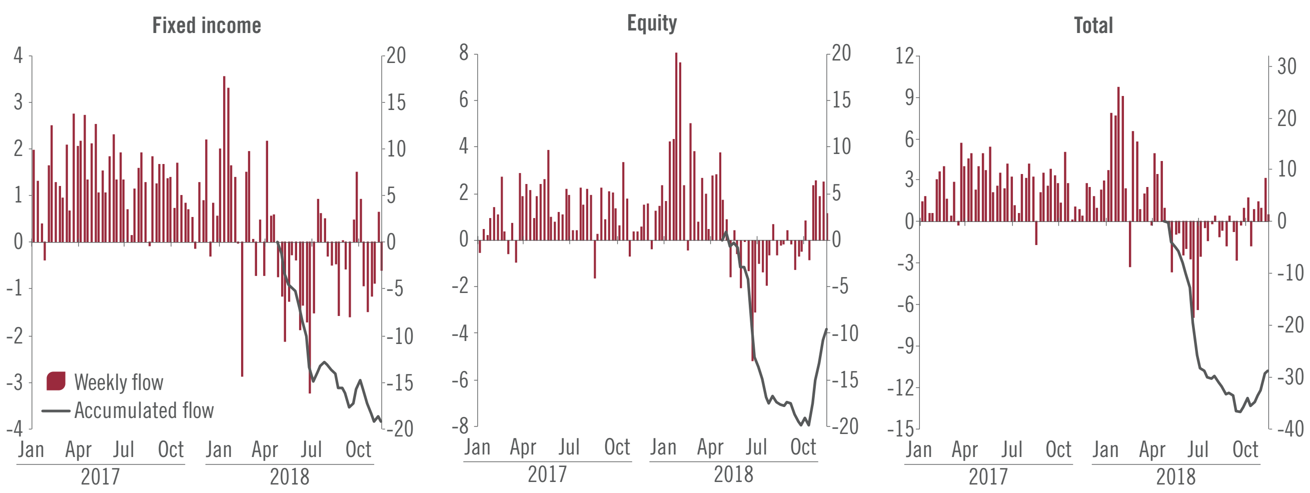
These developments included the upward trend of US interest rates, rising trade-related tensions, Chinese economic slowdown, the decline in key stock markets and heightened political and policy uncertainty in a number of EMEs, as well as a sharp decline in oil prices to levels not seen for around a year. As a result, financial conditions in these economies have demonstrated a significant tightening that, according to some estimates, is comparable to that experienced during the 'taper tantrum' of 2013 (see figure 2).

In the face of mounting pressure, the immediate policy response in EMEs has relied on two tools. First, monetary policy has generally become more restrictive, with reference rates increasing sharply in specific instances where conditions deteriorated more severely owing to persistent external vulnerabilities and perceived idiosyncratic risks. Second, the exchange rates of many EMEs adjusted in response to these shocks, with some currencies receiving support from foreign exchange intervention, either in the spot market or via derivatives.

Global tightening

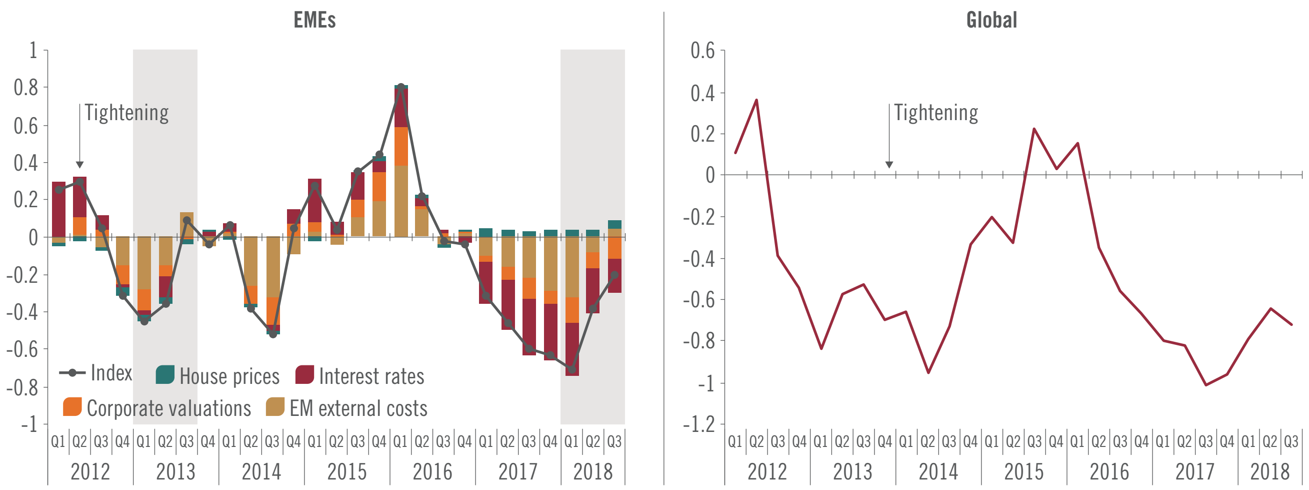
Among the factors explaining the reversal of capital flows and consequent tightening in broader EME financial conditions, monetary policy normalisation in the US is particularly noteworthy. Naturally, higher interest rates in the US could be

Figure 1 – Portfolio capital flows to EMEs (US$ billions)



Accumulated flows are from April 2018. Source: Emerging Portfolio Fund Research

Figure 2 – Financial Conditions Index (standard deviations from mean)



EMEs: Argentina, Brazil, Chile, Colombia, Egypt, Hungary, India, Indonesia, Kazakhstan, Lebanon, Malaysia, Mexico, Nigeria, Peru, the Philippines, Poland, Russia, South Africa, Turkey and Ukraine. Excludes China. Source: IMF

expected to represent a drag on capital flows towards EMEs. Notwithstanding some recent easing, market repricing of upside risks for the future trajectory of the federal funds rate in previous months led to outward pressures being stronger than anticipated.

In fact, more than 40% of the estimated outflows from EMEs in the first three quarters of 2018 that can be attributed to external factors was explained by increased market expectations about the US Federal Reserve Board's policy.

It is worth highlighting global financial conditions remain accommodative in relation to historical standards, albeit tighter than a year ago. There are many factors at play behind such an outcome, and their interrelationships are complex. Two stand out in this respect.

First, the tightening bias at a global level that may derive from interest rate increases by the Federal Reserve is, at least partially, countered by the persistent degree of accommodation pursued by the central banks of other major advanced economies (AEs), in what has turned out to be a divergent monetary normalisation cycle in these countries.

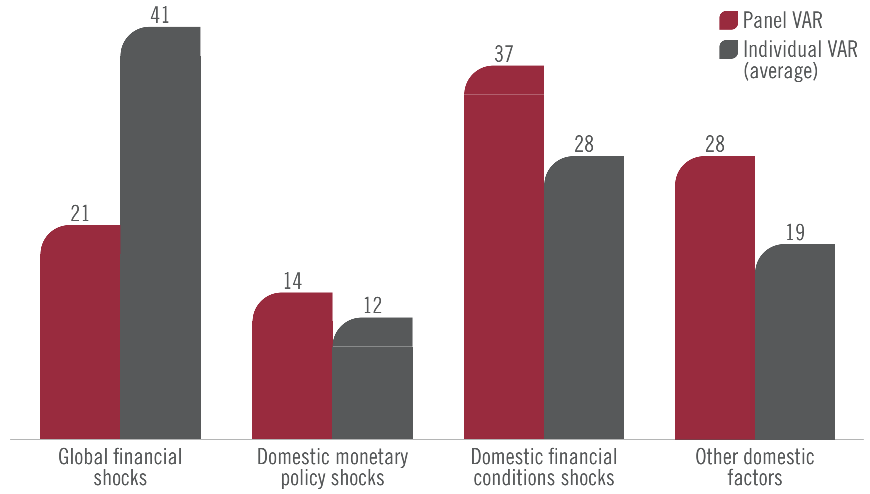
Second, in the US, domestic financial conditions actually loosened even as the monetary policy rate started to increase in December 2015 and the Fed began unwinding its balance sheet in October 2017. Financial conditions in the US started to tighten only around the beginning of 2018.

Such an outcome runs counter to intuition. However, it is important to bear in mind that an economy's financial conditions, broadly defined, are the result of the interplay of many variables, the impact of which may work in opposing directions. In the case of the US, the strengthening of the short-term growth outlook – in part resulting from the fiscal stimulus under way – may have raised expected corporate profits and thus supported asset prices through most of the run-up to the recent sharp market corrections. This effect was likely reinforced by the cross-border impact of large-scale asset purchases by central banks in Europe and Japan, thus stimulating demand for higher-yielding US securities. Furthermore, the tightening effects of monetary policy actions in the US may have been hindered by a gradual and, in general, predictable pace of increase in interest rates there.

In view of the difficulties inherent in trying to predict market movements – even more so in the context of unprecedented circumstances such as those prevailing – it is not at all clear how rapidly global financial conditions will tighten as the Fed and other central banks continue, or embark on, their respective policy normalisation cycles. To some observers, the recent adjustments in international financial markets – rising interest rates, declining stock indexes and depreciating currencies vis-à-vis the US dollar – are a welcome development, being consistent with a strong economic outlook, reduced risks of deflation in some AEs and, in general, a thus-far successful exit from the massive monetary accommodation of the decade following the outbreak of the crisis. However, the risk of a sharp tightening in financial conditions cannot be discounted.

At this current economic and political global juncture, several factors significantly increase the risk of a potentially disruptive scenario. First and foremost among these is the possibility of surprises in AEs' monetary policy normalisation. This is particularly worrisome in the case of the US, where – notwithstanding downward adjustments in market expectations about the future path of interest rates following the recent market rout – inflation could surprise the upside as a result of ongoing fiscal stimulus measures in an economy operating at, or near, full capacity,

Figure 3 – Share of domestic Financial Conditions Index fluctuations attributable to global and domestic factors (%)



Estimation results for a panel value-at-risk (VAR) model or individual VAR models in a sample of countries with flexible exchange rates. Source: IMF

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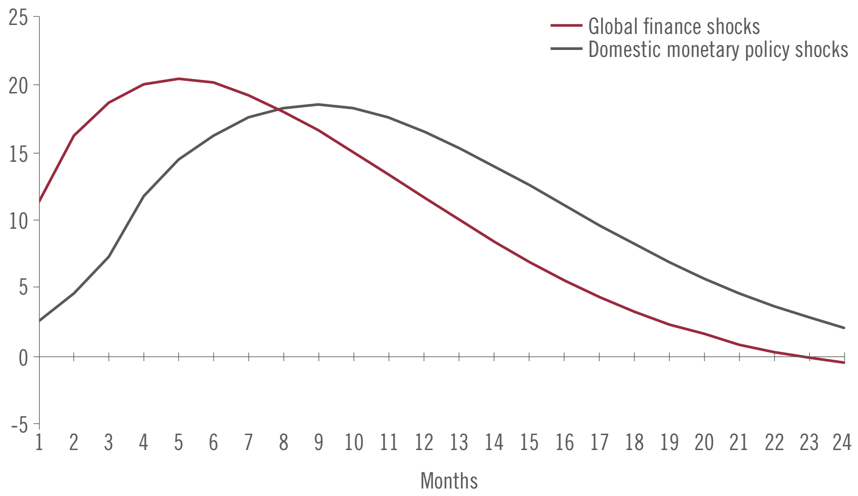
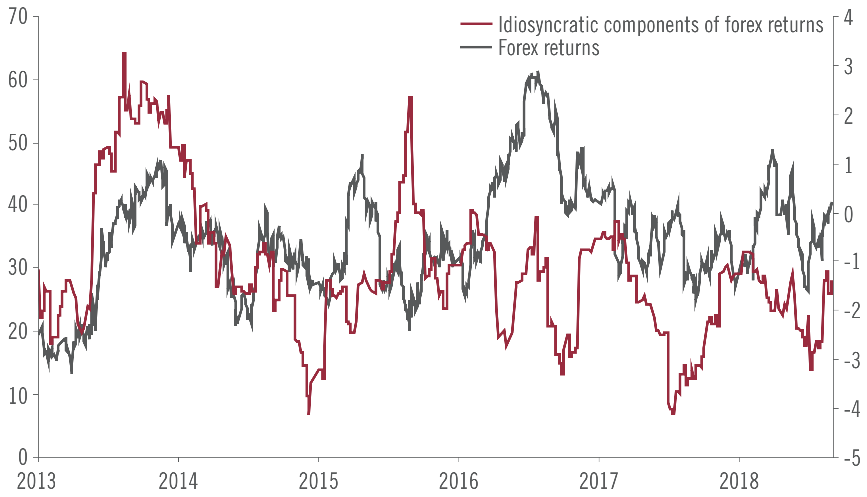
Figure 4 – Response of domestic financial conditions to shocks (%)



Impulse response functions of domestic financial conditions indexes to global finance or domestic monetary policy shocks for a sample of countries with flexible exchange rates, based on a panel VAR model.
Source: IMF

Figure 5 – Correlation between forex returns and idiosyncratic components of forex returns (median pairwise correlations %)



Source: IMF

in addition to price pressures that may derive from increased import tariffs.

Second, market sentiment might be adversely affected by increased political and policy uncertainty in a wide range of economies – both advanced and emerging. At the top of these concerns is the further escalation – or at least the persistence – of global trade tensions, especially between China and the US, the broader implications of which can well go beyond the current areas of dispute.

Third, confidence in the resilience and credibility of policy frameworks in EMEs may erode, as external shocks combine with existing vulnerabilities.

Structural challenges

In addition, structural challenges may further complicate matters. First, as previously noted, the context in which monetary policy normalisation in the US and other AEs is taking place is unprecedented, in turn making its potential ramifications difficult to foresee and assess. For one, interest rates have never been so low for so long, while the unwinding of the stimulus provided by unconventional monetary policy measures adopted at such a large scale remains untested. In light of these and other uncertainties, including those related to the characterisation and definition of 'normality' itself, it is evident that the potential for policy mistakes is sizeable. On one hand, adjusting policy too fast may, among other things, prompt disruptive responses in international financial markets, with adverse implications for the real economy at both domestic and international levels. On the other hand, moving too slowly may encourage the continued accumulation of debt as well as the build-up of risks and vulnerabilities in the financial sector.

Second, on account of the greater financial integration across markets and economies brought about by globalisation, the control of domestic financial conditions by policy-makers may prove quite challenging (see figures 3 and 4). Some estimate that around 20–40% of the observed variation in domestic financial conditions can be explained by a single common factor, namely global financial conditions, an effect that tends to be greater – more than 60% in some instances – in EMEs. The situation is further complicated by the fact that local financial conditions tend to react faster and more strongly to external shocks than to adjustments in the domestic monetary policy stance. Furthermore, it is common for external financial conditions to be driven to a larger extent by factors other than macroeconomic conditions, such as abrupt swings in investor sentiment, financial contagion or regulatory changes, when tools to counter them may be more limited or less effective.

Third, the global financial structure has undergone profound post-crisis changes, which remain untested under widespread stress. One of them relates to evidence suggesting an increased segmentation of market liquidity, and the consequent risk that lower levels of liquidity enhance the potential for wide fluctuations in asset prices and financial stability. In this respect, the abundant liquidity resulting from overly expansionary monetary policies in AEs is anticipated to decline significantly in coming years.

Another change is the increased presence of foreign investors in local EME bond markets. It is true the level of risk is a function of the type of investor, with large institutional investors generally displaying a higher degree of stability. It is also the case that, in the final analysis, both foreign and domestic investors will have similar reactions to episodes of acute turmoil. However, it can also be argued that non-resident holders of domestic assets may be more sensitive to the impact of shocks, especially in cases with a significant share of investors operating through mutual funds and exchange-traded funds.

Clearly, EMEs should stand ready to face the materialisation of these and other risks. While isolation from changes in global financial conditions is unfeasible, the evidence clearly shows that domestic policies make a crucial difference. As in previous episodes of turmoil, global investors have differentiated EMEs on the basis of their economic fundamentals and other idiosyncratic factors. For instance, the deterioration of indicators of creditworthiness and currency depreciations has been sharper in countries facing more important economic and political challenges. Similarly, estimations of correlation of the idiosyncratic component of market exchange rates – or, more generally, of contagion among different EMEs – have increased recently, but they remain at low levels (see figures 5 and 6).

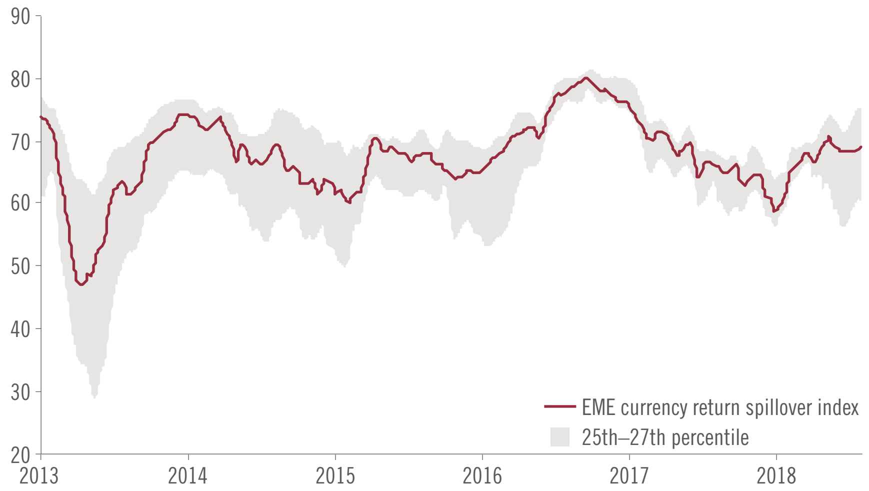
It would be naive and unfair, however, to assume EMEs will be able to overcome these challenges by themselves. Maintaining global financial stability is a complex task, and therefore its attainment and preservation is a shared responsibility that requires co-ordinated efforts from all parties. The role of AEs in this task is paramount to its fulfilment. Indeed, a careful communication of monetary policy decisions, a proper evaluation of spillover effects, strong support for the creation of an adequate global financial safety net and even co-ordinated policy action whenever needed, among other actions, should be the key ingredients of this co-operative approach.

AEs bear a clear responsibility for the current state of the world economy and should therefore assume an equally important role in overcoming the consequent challenges. But, beyond this, it is evident they also have much to gain from a solid performance of EMEs and stable global financial markets.

By virtue of their growing importance and integration into the global economy and financial system, the scope for spillovers from EME shocks into AEs has risen over the past decades to significant levels. According to International Monetary Fund (IMF) estimates, more than one-third of the variation in AEs' stock market returns and in their exchange rates in recent years can be traced to spillovers from EMEs. Moreover, given the current extent of financial market integration and the unique features of international financial markets, financial volatility in EMEs may be widely transmitted even in the absence of crisis or near-crisis episodes (see figure 7).

In other words, policy-makers in AEs need to carefully consider not only the consequences of their policy decisions on EMEs, but also the risk of spillbacks from EMEs as a result of policy actions in AEs. The implications for international policy co-operation are self-evident.

Figure 6 – Currency Return Spillover Index (%)



The spillover indexes are based on the methodology by Diebold and Yilmaz (2009), using EME currency returns (local currency versus USD exchange rates). The index is the contribution from a shock to market X to the overall variability in any other market Source: IMF

Figure 7 – Financial spillovers from EMEs to an average AE (% points)

Financial market spillover indexes measure the fraction of the average AE's returns that can be accounted for by variations in EMEs' returns. Source: IMF

Redesigning the international
trading and monetary system

FIEs – A fair hearing, please

Recognising the importance of foreign-invested enterprises (FIEs) to China's growth, *Harley Seyedin*, special adviser to the chairman at the George H.W. Bush Foundation for US-China Relations, calls for new mechanisms to stop FIEs falling foul of local authorities

There seems to be prevailing opinion in the US that 90% of its jobs have gone to China. To some degree, everyone – at least among the general public – believes the US-China trade deficit is killing the US economy, and it is thought that US consumers are spending most of their money on Chinese products. This article examines a study carried out by the US Federal Reserve and reveals the reality of the situation.

In descending order, US GDP comprises four parts: consumer spending; government spending; business spending; and the difference between exports and imports, a deficit in the case of the US. Around 70% of GDP is consumer spending – more than US$19.6 trillion. Most people, including many politicians, seem to believe the vast majority of this is spent on goods made in China.

The report by the Federal Reserve Bank of San Francisco in 2011 indicates that, of the 70% – not 50, 80 or 90% – of GDP that is consumer spending, only 1.2% actually goes to China.[1] US consumers are definitely not spending a significant percentage of their money on Chinese goods – only 1.2% is actually going to China.

It is therefore difficult to understand the goal of the US in this argument – should it try to reduce 1.2% to 1%? To 0.8%? When will it achieve those numbers?

The US trade deficit – the fourth part of GDP – amounts to $375 billion. This sounds like a lot of money, but is actually less than 2% of US GDP. To break that down into smaller numbers: if US GDP were $1,000, its trade deficit would be $20. That certainly does not throw an entire economy apart. Putting the numbers into perspective, the trade deficit does not seem a big problem. What is the goal – to reduce that $20 to $15 or $10?

Unlevel playing field

The question we have to ask is: What are we actually arguing about? US businesses in China are justified in asking where the goalposts are. They have faced difficulties in China, and I would like to address the real solution, which is the two countries sitting down and, honestly and in private, talking about and settling their issues. I think that's very achievable.

Are there intellectual property rights (IPR) issues? Certainly there are in the opinion of one expert on IPR issues in China. He feels China has passed all the laws it needs, and that at central government and provincial levels sufficient enforcement exists. The problem arises at local levels, where enforcement needs to be improved and become more airtight. The two countries can work together to implement this; perhaps the US can share its methods and technologies to help China achieve full IPR protection.

Harley Seyedin

Of IPR arguments filed in Chinese courts today, 99% are by Chinese organisations against other Chinese organisations. IPR protection is just as important to China and its own innovation-based economy as to foreign technology. The US and China must co-operate and work out these areas.

On the losing side

An uneven playing field is undeniable: state-owned enterprises (SOEs) in many situations are preferred, not necessarily openly at the central government level, but at many local levels. Private companies are hurting. To cite a personal example: in one of my own investments in China I had a dispute with a local SOE, the government intervened and we took it to arbitration as agreed. The government then cancelled the land-use rights, which ended the argument. We lose, they win: this is happening all across China and needs to be addressed.

As president of the American Chamber of Commerce in South China (AmCham South China), which represents more than 2,300 companies, there is no single entity I can approach to discuss a company's problem with another company. China really needs to reach out to the three major American chambers in China – Beijing, Shanghai and AmCham South China.

A mechanism should be set up at the highest level to bypass authorities at local and provincial levels so the chambers can present their problems, have a fair hearing and obtain a resolution at central government level. It's not a matter of taking sides, but of allowing a company to have a fair and honest hearing without fear of unfair treatment from local courts or entities, as I experienced.

A closed economy is not possible for China when FIEs play such a major role in boosting GDP, innovation and progress

AmCham study

AmCham South China released a study in October 2018 that revealed US companies are being damaged through tariff and counter-tariff friction more than Chinese companies.[2] Our assessment of the situation has been honest, and we have not falsely told our leadership: "Great job, you're succeeding." The study also showed that this trade friction is not just wounding Chinese and American companies, but is taking a substantial toll on companies from other countries either working in or with facilities and operations in China and other places.

This trade war is hurting supply chains, labour movement and investment plans going forward, and it has created more uncertainty. If it continues for a long time, it is going to be very disruptive to investment matter, supply chains, labour and population movement, transportation, shipping lanes, innovation, economic development, and so on. We see no benefit from this trade friction and suggest there are much better ways to address these issues.

Professor Michael Enright at the University of Hong Kong undertook a 16-month study of the impact of foreign-invested enterprises (FIEs) on China's economy.[3] The study shows that China is one of the most open economies in the world, even though there is a need for it to 'open up' further via greater reform. The impact of FIEs was analysed across China using two indicators: investment by foreign enterprises, and salaries spent by their employees.

Across China, 33% of GDP is created by FIEs, as is 27% of employment. Shanghai, for example, has the highest concentration of FIEs on China's east coast. Here, 67% of industry output is created by FIEs, 90% of its hi-tech output and one-third of employment. In Shenzhen, half of all GDP and employment is created by FIEs. A closed economy is not possible when FIEs play such a major role in boosting GDP, innovation and progress.

China is and will continue to be very important to the global economy going forward, and for the past 20 years has contributed a large share of growth to the world economy. We want to work with China to ensure that continues. Certainly, we can convince our leadership, but first I need to convince our companies that we have a mechanism where they can be heard and their difficulties can be addressed quickly.

1. *G Hale and B Hobijn, Federal Reserve Bank of San Francisco,* The US content of "Made in China"*, August 2011, https://bit.ly/2FrsY9i*
2. *American Chamber of Commerce in South China,* 2019 special report on the impact of US and Chinese tariffs*, https://bit.ly/2VURsfV*
3. *MJ Enright, Hinrich Foundation,* Developing China: The remarkable impact of foreign direct investment*, September 2016, https://bit.ly/2UkHpzH*

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The Silk Road International Association (SRIA) is committed to building an open and interconnected global network. Through the Silk Road Spirit of "Peaceful Co-operation, Openness and Inclusiveness, Mutual Learning, Mutual Benefit and Win-Win", it unites international community, global market and private capital to build an effective co-operation and dialogue mechanism for the Silk Road.

- Implementing the Belt and Road Initiative
- Building the Silk Road Diplomacy and Co-operation Mechanism
- Diversifying International Community Co-operation
- Developing Global Market-oriented Investment and Financing Services
- Jointly Generating and Sharing the Belt and Road Harvest
- Integrating Alliance Resource and Serving Members

THE BELT AND ROAD INITIATIVE

A new driver for globalisation?

The second Belt and Road Initiative (BRI) Survey of 28 central banks reveals that they view the BRI as a major driver of globalisation, with a high percentage of respondents expecting the initiative to provide a significant boost to GDP. So far, political interference by 'major countries' has had little effect on BRI projects, but this could change in the future. By *Zhang Jizhong* and *Christopher Jeffery*, with research by *Rachael King*

Yamdrok Lake, Tibet

The Belt and Road Initiative (BRI) has been a beacon in the past five years as a China-led effort with the aim of supporting global economic growth and development. For this reason, the BRI stands out at a time when many existing multilateral efforts are facing significant problems.

The Doha Round of World Trade Organization (WTO) talks has been stalled for some time, and progress to reform the Bretton Woods Institutions – the World Bank and the International Monetary Fund (IMF) – has proven slow. Some nations – in particular the US, which established much of the existing multilateral framework – are taking unilateral actions that have the potential to undermine the decades-long drive towards global development.

Against this backdrop, the BRI has expanded the breadth of its efforts to promote inclusive international co-operation as part of President Xi Jinping's efforts to "boost mutual understanding, mutual respect and mutual trust among different countries", and promote a "new type of international relations featuring win-win co-operation".

The Chinese government's Belt and Road Portal now lists 124 countries and 29 international organisations – including recent additions Italy and Luxembourg – engaged in international co-operation on the BRI,[1] compared with the 71 reported in last year's survey. Many African and Caribbean nations have joined the ranks of Asian and European countries by supporting the initiative.

Most of these jurisdictions, although not all, are emerging or developing nations, with many requiring substantial development funding – something China has provided in hundreds of billions of US dollars to date. Projects range from the US$8.7 billion railway from Mombasa in Kenya to the Ugandan border, to energy deals in Nepal.

Although much discussion has centred on Chinese-led funding along the BRI for infrastructure and other development projects – utilising skills China has secured during its own 40-year economic transformation – the BRI has also fostered a spirit of co-operation in a number of countries.

Examples of this can be observed in Central Asia. For example, Kazakhstan celebrated 2018 as 'the year of Uzbekistan', while Uzbekistan has named 2019 'the year of Kazakhstan'. The arrangement is characterised as symbolising the role of Kazakhstan as the entry point for the 'western branch' of the Silk Road Economic Belt and Uzbekistan as the entry point for its 'southern branch'. It highlights how the BRI is helping nations to forge stronger relations with each other. The BRI may also have helped in the process of improving the legal status of the Caspian Sea in terms of the areas of control claimed by Russia, Iran, Turkmenistan, Kazakhstan and Azerbaijan.

Another less-discussed area are efforts by the Chinese authorities to set up international commercial courts in Shenzhen and Xi'an to address commercial disputes related to BRI projects. These are likely to be based on courts similar to those in the Dubai International Financial Centre and demonstrate another 'soft' development taking place in addition to 'hard' infrastructure investments.

The BRI may also be about to gain traction among the Group of Seven, with Italy becoming the first major developed economy to endorse the BRI. Twenty-nine deals amounting to €2.5 billion were signed in Rome in March 2019. The UK, Germany, Italy and France are already members of the Asian Infrastructure Investment Bank, which has invested in projects in BRI countries.

Italy's position, however, appears at odds with that of some of the other European Union member states, and the US has publicly voiced its objections. The US administration under President Donald Trump has become noticeably more critical of the BRI than the previous Obama administrations. "We view the BRI as a 'made in China, for China' initiative", is the refrain of some US officials, in an apparent reference to the benefits being stacked in China's favour. An often-cited example is that of Sri Lanka, which, after struggling to make payments on its debt to Chinese firms, ceded control of its major port of Hambantota to China for 99 years. A report published in March 2018 by the Center for Global Development also claimed the BRI has created "the potential for significantly increased debt sustainability problems" in "at least eight countries" – Djibouti, Kyrgyzstan, Laos, the Maldives, Mongolia, Montenegro, Pakistan and Tajikistan.

PROFILE OF RESPONDENTS

Central Banking received responses from 28 central banks participating in the Belt and Road Initiative. Over half of respondents were European, and Asian respondents made up 15% of the replies. Central banks from the Middle East and Oceania also featured and, for the first time, responses were received from African countries. More than two-fifths of responses to the 2019 survey were received from developed countries, with one-quarter of respondents from emerging market economies.

Region	% of respondents
Europe	54
Middle East	11
Asia and Oceania	21
Africa	11
South America and the Caribbean	4

Economic classification	% of respondents
Emerging market	25
Transition	18
Developing	14
Industrial	43

Percentages in some tables and graphs may not total 100 due to rounding.

Risks for China

Part of the problem is that many of the countries included in the BRI are already ranked by the Organisation for Economic Co-operation and Development as being some of the world's most risky economies.[2] But this does not mean they do not need to develop.

Then there is the issue of a newly elected government taking a polar view on a major infrastructure initiative that was wholeheartedly supported by its predecessor.

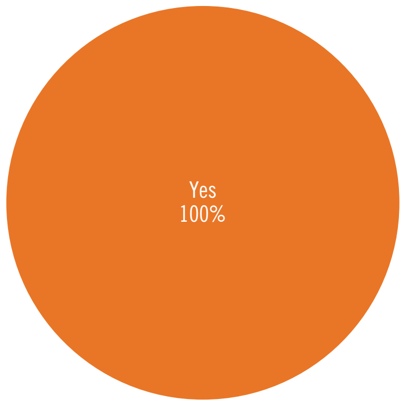
This was witnessed in the Maldives after Ibrahim Mohamed Solih succeeded Abdulla Yameen as president. Another obvious example emerged in August 2018, when the newly re-elected prime minister of Malaysia, Mohamad Mahathir, planned to cancel three BRI projects in Malaysia, having earlier suspended them. However, despite the cancellation of these projects because of concerns about runaway costs, Malaysia still supports the BRI. "China's BRI will promote regional exchanges and co-operation, which will benefit all countries in the region," Mahathir said.[3]

Chinese officials are well aware that better attention is needed to address concerns about project viability, debt sustainability, transparency and the geographic diversity of contractors. However, the results of the BRI survey of central banks provide evidence that many nations still have a positive perception of the benefits of the BRI – indeed they unanimously regard it as an essential initiative to support globalisation and bolster economic growth.

Key findings

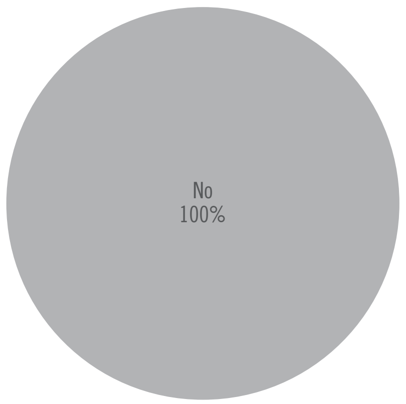
- All central banks viewed the BRI as an important measure to promote globalisation.
- All countries expected the BRI to boost China's GDP, with 16% believing the boost would be between 2 and 10 percentage points over the next five years.
- More than half of respondents expected a GDP boost of between 1 and 2 percentage points over the next five years.
- No BRI projects have been influenced by political pressure linked to the US-China trade war.
- Relations with major nations are viewed as the greatest challenge to the BRI.
- No BRI projects have faced increased financial pressures.
- There is limited concern about debt sustainability, with 75% of respondents saying any problems linked to the BRI are limited to fewer than five countries.
- A total of 86% of respondents reported BRI-related debt to be smaller in scale than other external debt, and a similar percentage believed home-country BRI debt was sustainable.
- More than half of respondents said BRI-related debt carried less onerous terms and conditions than other external debt.
- Nearly three-quarters of respondents believed other development initiatives will complement BRI initiatives.
- Near four-fifths of central banks expected the BRI to support infrastructure projects in their home jurisdiction.
- Most of the BRI support would focus on major infrastructure, followed by mega-infrastructure and small and medium-sized enterprise (SME) financing.
- There was a perception of limited support for financial inclusion initiatives.
- Central banks generally found green finance to be related to the promotion of the BRI.
- Only 40% believed the BRI would help achieve global climate change commitments.
- Central banks were divided on whether or not the BRI would support the upgrading of home-country technological capacity.
- Regulatory transparency, support by development banks and co-ordination were the main areas where the BRI could be improved.
- A total of 43% of central banks would favour domestic funding for BRI projects.
- The US dollar edged out the euro and renminbi as the favoured foreign funding currency.
- Central banks would support BRI local currency payment and settlement systems.
- Just over half of central banks would favour opening the local currency business for trade-related purposes.

Figure 1 – Given the current international economic situation, is the BRI an important measure promoting globalisation?



Fourteen central banks did not respond.

Figure 2 – Has the implementation of BRI-related projects in your jurisdiction encountered any increased international political pressure?



Fifteen central banks did not respond.

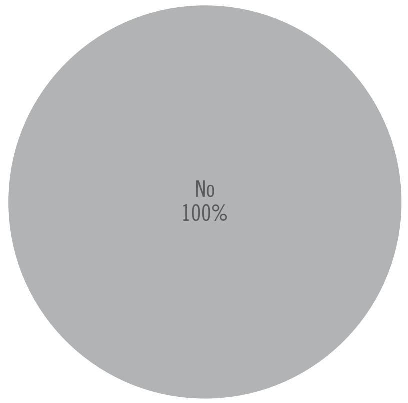
Survey responses

Underpinning globalisation

The BRI is viewed by many policy-makers as an important effort to reinforce globalisation. This was certainly the view of central banks responding to this year's survey. These respondents from around the world were resoundingly of the view the BRI is "an important measure" for "promoting globalisation". Not one respondent challenged this view (see figure 1).

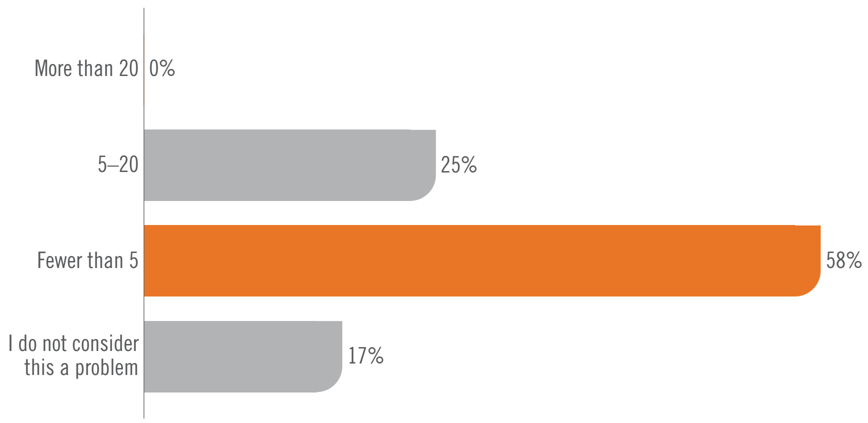
"The very objectives of the BRI – in effect to link Asia, Europe and Africa to foster economic and cultural ties – promote globalisation," said one African central bank. "In the current international economic situation, the BRI offers countries (including in Africa) the needed financing to develop their infrastructure and grow their economies."

Figure 3 – Has the implementation of BRI projects in your jurisdiction encountered any increases in financial pressure?



Fourteen central bank did not respond.

Figure 4 – In how many countries are you concerned the BRI is causing debt to reach unsustainable levels?



Sixteen central banks did not respond.

A European central bank added it sees the BRI as an important driver for development and growth, "considering that it tries to foster trade, economic and financial integration over a vast area, comprising a large number of countries".

Indicating the geographic reach of the BRI – the Chinese government's *Yi dai, yi lu* portal says 124 countries and 29 international organisations are now included in the BRI[1] – a Caribbean central bank believed the BRI "can assist in expanding trade volumes and reduce costs through the utilisation of improved trade channels".

One of the obvious challenges with the BRI is, given its breadth and scope, different parties have somewhat different interpretations of how it should be implemented. A European central bank, for example, said the BRI "needs to comply with WTO rules", and "should not actively seek to build up closed or exclusive networks of trade and production".

Closer to China, however, a Southeast Asian central bank said the BRI is "not as much mentioned as before", indicating the expansion into many new countries and organisations may be somewhat diluting. Nonetheless, this central bank said the BRI "is still important to the development and growth in this region".

Not feeling the pressure

None of the central bank respondents said their jurisdictions had encountered any increased international political pressure related to BRI projects due "to heightened China-US trade frictions" and "a tightening of US monetary policy" (see figure 2). This view was summed up by one central European central bank, which stated: "We have not observed any overt external political or geo-strategical move to the contrary."

It was a similar situation when it came to revealing issues related to implementing BRI projects in home jurisdictions – for example, onerous financial pressures and other challenges. None of the respondents to the survey said they had faced such difficulties (see figure 3). However, in their comments, it appears a number of respondents represented countries where major BRI projects are not in full swing.

"There is presently no implementation initiative related to the BRI," said one central European central bank. Another policy-maker mentioned its country had only recently signed a memorandum of understanding with China on the BRI. Another central bank pointed out that it only played a "facilitation role in financing and investment in infrastructure".

Central bank respondents did not appear too concerned about debt sustainability in other countries either. Seventeen per cent of respondents reported there was no problem, with 58% saying any problems were limited to "fewer than five countries" – meaning three-quarters of respondents believed debt issues were restricted to less than five countries. Of the 25% of respondents that believed debt sustainability was a more prevalent issue, all of them said the problem was limited to between five and 20 countries (see figure 4).

Figure 5 – Relative to other external debt, how significant is BRI debt in your jurisdiction?

Twenty-one central banks did not respond.

Figure 5a – Is BRI-related debt in your jurisdiction sustainable?

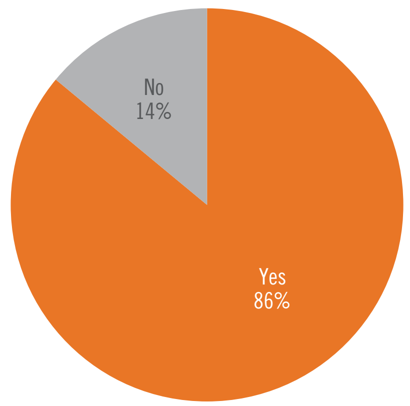


Figure 5b – How onerous are the terms and conditions of BRI-related debt in your jurisdiction relative to other external debt?

Countries specifically highlighted as having issues included Sri Lanka – which, after struggling to make payments on its debt, relinquished control of Hambantota, its major port, to China for 99 years – and Djibouti, where China has established its first overseas military base.

One European central bank said: "This may be a problem for countries with weaker macroeconomic fundamentals and/or relatively high levels of external debt."

None of the responding central banks felt they had especially large debt exposures related to the BRI. Just 14% put their external debt related to the BRI as similar in scale to other foreign debt, with the rest reporting it was smaller in scale (see figure 5). A total of 86% of central banks viewed their jurisdiction's BRI debt as "sustainable", although 14% viewed it as unsustainable (see figure 5a). This could reflect that, while BRI debt may not be larger than other forms of debt, it may have been taken on more recently and so puts a country closer to a potential 'tipping point'.

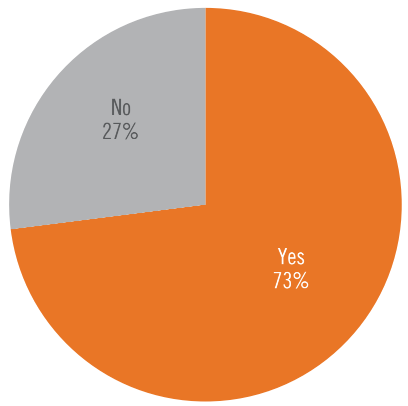
While 43% of central bank respondents said BRI-related debt had similar terms and conditions to other external debt, the majority (57%) of respondents viewed BRI debt as having less onerous terms and conditions (see figure 5b). This may explain why some relatively highly debt-laden countries are keen to seek out BRI funding from China.

"Sources of external financing for us have been both bilateral (including from China) and multilateral in nature, and have also included financing from international capital markets," said one developing economy central bank. "As we prepare to exit our current programme with the IMF and to [move beyond aid, the government] is seeking sources of long-term finance to help it address its infrastructure and development needs. In this regard, we are hoping to get some further support from China."

Co-operative initiatives?

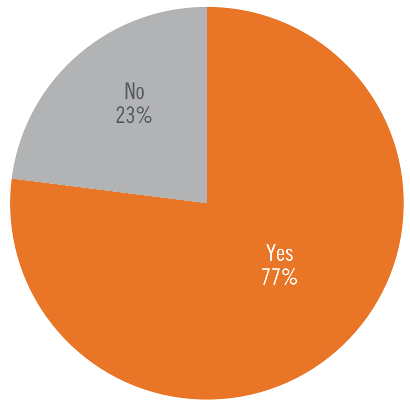
Other countries and regions such as the EU, India, Russia and Japan have proposed and implemented initiatives and/or development plans with similarities to China's BRI. When asked for their views on whether or not these initiatives and development plans could co-ordinate with the BRI, nearly three-quarters of

Figure 6 – Could similar initiatives to the BRI co-ordinate with it?



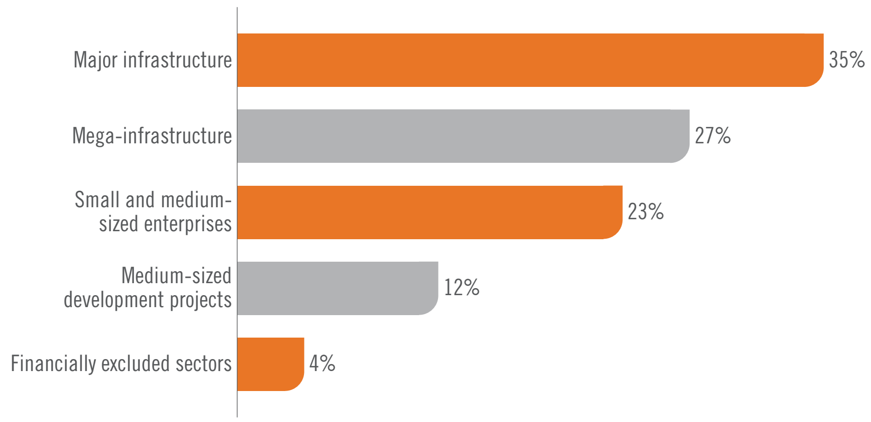
Seventeen central banks did not respond.

Figure 7 – Do you expect the BRI to support infrastructure projects in your jurisdiction?



Fifteen central banks did not respond.

Figure 7a – If yes, where do you expect the most support?



Central banks were invited to select more than one answer.

respondents said they could, while just over one-quarter did not see co-operation as possible (see figure 6).

One European central bank stressed co-operation on initiatives and development plans "would tend to depend on specific initiatives at hand". But an Asian central bank said: "The BRI reaches many regions of the world – it is inevitable that those other initiatives will have to co-ordinate with the BRI."

Building an infrastructure

While the BRI is designed to promote many forms of cross-cultural exchange and connection, it has also made rapid progress in supporting infrastructure projects worldwide. Close to 77% of central banks surveyed said they expected the BRI to support infrastructure development in their region (see figure 7).

Of this funding, central banks expect the most support (35%) for major infrastructure (such as roads, factories and agricultural water conservation); followed by (27%) mega-infrastructure (for example, power stations and high-speed railway networks); then (23%) SME enterprises; then (12%) medium-sized development projects (schools, hospitals, housing, minor transport links, and so on); trailed by (4%) financially excluded sectors (see figure 7a).

Green financing

China has learned to its cost that rapid industrialisation can have severely negative consequences for the environment. As it moves to recalibrate its economy towards high-tech industry, services and consumption, it has also placed an increasing focus on green finance, where the finances raised are explicitly used to fund environmentally responsible projects and businesses.

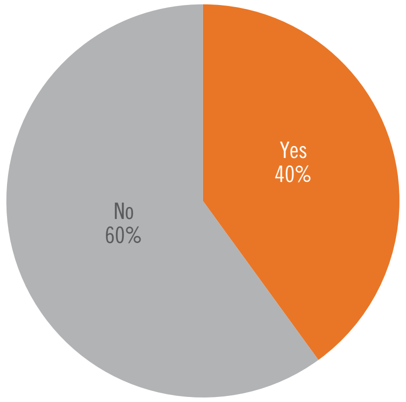
More than $30 billion of Chinese green bonds have been issued, and Chinese banks have started to issue BRI-focused green bonds. For example, the Industrial and Commercial Bank of China issued $2.15 billion of BRI green climate bonds in Luxembourg in late 2017, with the proceeds to fund renewable energy, low-carbon transportation and sustainable water management, among other areas.

This effort is having some effect, with 40% of central bank respondents saying the BRI would help to achieve global climate change commitments (see figure 8). "This is not an explicit goal of the BRI, but it may be a positive externally," said one Caribbean central bank. But the majority (60%) currently believes this is not the case. "It is not expected the BRI will help to achieve global climate change, due to the required infrastructure and investment projects, which result in more climate changes," said one Middle Eastern central bank.

China's funding of coal-fired power plants in countries such as Pakistan that would have struggled to secure funding from multilateral lenders for such heavily polluting plants highlights the conundrum for China and developing countries. Pakistan has large coal resources but not gas. If it secured funding for gas-fired

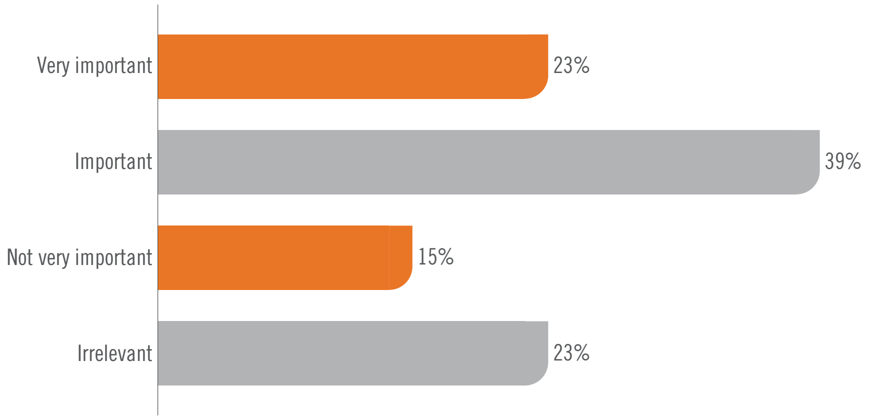
The Belt and Road Initiative

Figure 8 – Will the BRI help achieve global climate change commitments?



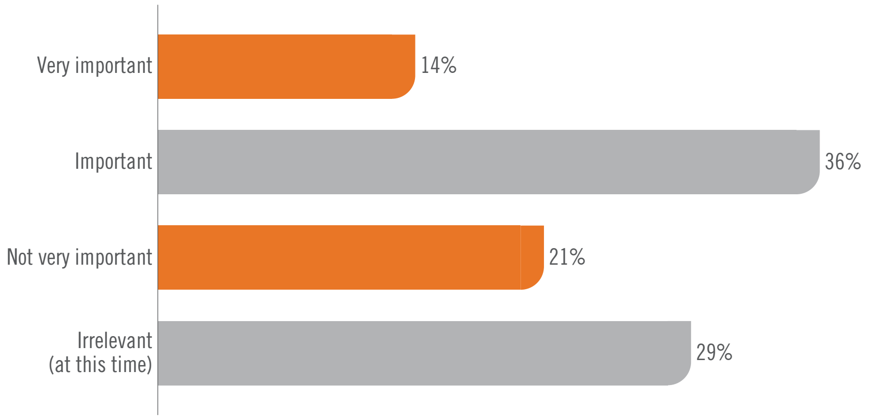
Fifteen central banks did not respond.

Figure 8a – To what extent is sustainable/green finance related to the promotion of the BRI?



Twenty central banks did not respond.

Figure 9 – How important is the BRI in helping to upgrade technological capacity in your jurisdiction?



Fourteen central banks did not respond.

A road to Kyzyl-Oi, Kyrgyzstan

power stations, it would need to import the gas, placing a strain on its national finances. Coal, on the other hand, does not need to be imported. But coal-fired stations are generally viewed as less environmentally friendly than gas-fired stations.

Central bank respondents believe a sustainable and green focus is important in the promotion of the BRI, with 23% saying it is "very important" and another 39% saying it is "important". Meanwhile, 38% of central banks said it was either "not very important" or "irrelevant" (see figure 8a).

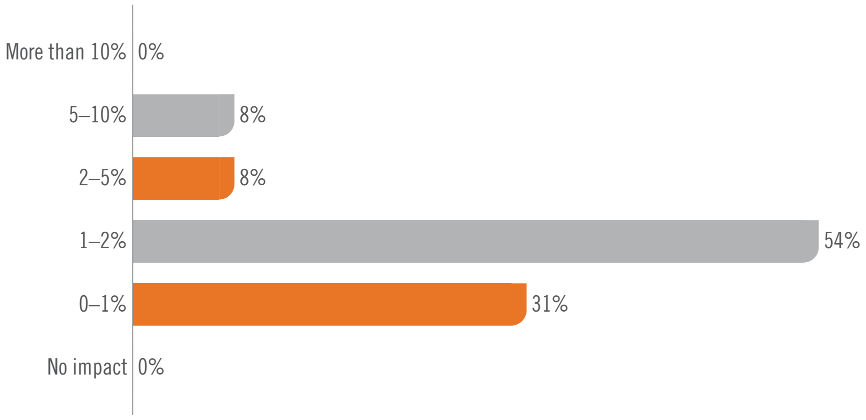
Central banks were split on their views about the importance of the BRI in terms of helping to upgrade technological capacity in their jurisdiction. A total of 14% said they considered the matter "very important", and 36% "important", but not essential; while 21% said they viewed it as "not very important", and 29% as "irrelevant" at this time.

GDP boost

All respondents to the survey expect the BRI to lead to an increase in China's GDP over the next five years, with 70% expecting the BRI to boost growth by more than 1 percentage point. Most central banks expected an increase of between 1 and 2 percentage points. But 8% expected GDP to rise by 2–5 percentage points; while another 8% said they expected an even greater boost of 5–10 percentage points (see figure 10).

Asked which aspects of the BRI should be improved, central banks gave

Figure 10 – How much do you expect China's GDP to increase because of BRI-related projects over the next five years?



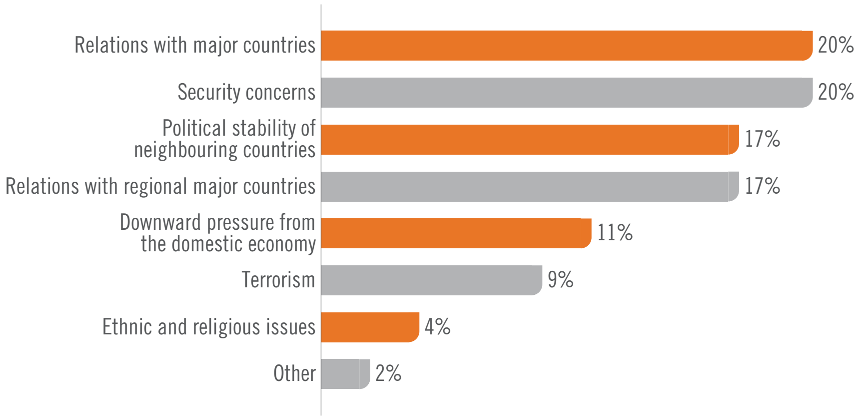
Fifteen central banks did not respond.

Figure 11 – BRI aspects that require improvement

Region	1	2	3	4	5
Project selection	8%	31%	0%	54%	8%
Regulatory transparency	31%	15%	15%	15%	31%
Ethics	8%	8%	46%	15%	23%
Co-ordination with the national development strategy or regional strategy projects of BRI countries	23%	46%	15%	15%	0%
Financial and project management support by development banks	31%	0%	31%	0%	38%

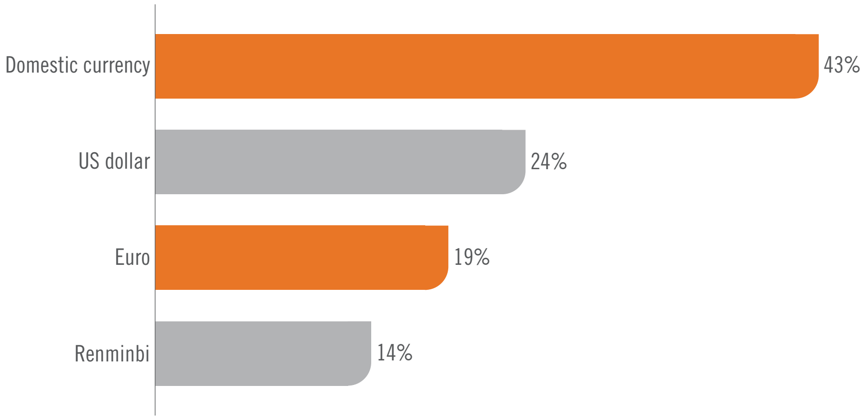
Votes were cast using a scale of 1–5, where 1 denotes the most urgent aspect and 5 the least urgent. Fifteen central banks did not respond.

Figure 12 – The most significant challenges BRI countries currently face



Central banks were invited to select more than one answer. Fourteen central banks did not respond.

Figure 13 – What currency would you advocate being used for financing Belt and Road-related projects?



Central banks were invited to select more than one answer. Fourteen central banks did not respond.

"regulatory transparency" and "financial and project management support by development banks" as primary concerns. The biggest secondary issue was related to "co-ordination with the national development strategy or the regional strategy projects of BRI countries". "Ethics" and "project selection" were much lower down their priority lists, perhaps in contrast to last year's survey, in which a combined option of ethics and transparency scored very highly (see figure 11).

Identifying the most significant challenges BRI countries currently face, there was limited concern about terrorism, ethnic and religious issues, and downward pressures from domestic economies. The greatest challenges came in the form of relations with other countries, with 20% citing "relations with major countries" and 17% citing "relations with regional major countries"; 20% cited "security concerns (wars and military conflict)" (see figure 12).

Financing currency

When it came to the most appropriate funding currency, more than two-fifths (43%) of central banks – regardless of geographic location – said they would advocate the use of their domestic currency for financing BRI projects (see figure 13).

"Using domestic currency will mitigate possible currency mismatches that contractor firms might experience in their balance sheets," said one G20 central bank.

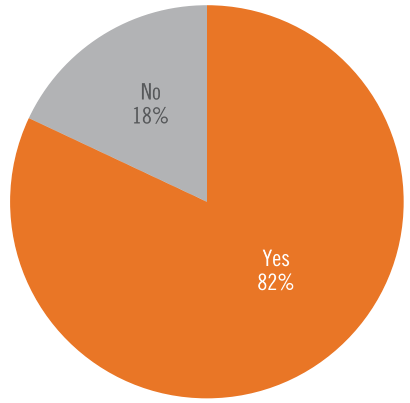
"Domestic currency loans will eliminate foreign exchange risk and reduce the risk of default," added an African central bank.

Other central banks, including one European central bank, pointed out that foreign currency financing may make sense if there is "some sort of natural hedge, in the form of trade revenues". Another major African central bank said: "There could be a need to have payment in an international currency, given that the projects will in some instances be undertaken by international companies."

When it came to funding in foreign currencies, the US dollar was the most preferred, with 24% of the overall votes, followed by the euro with 19% and the renminbi with 14%.

Given recent global political events, it is somewhat surprising to see the US dollar grow in popularity among BRI countries.

Figure 14 – Would you support the establishment of a multiple, local currency payment and settlement system?



Seventeen central banks did not respond.

Figure 14a – If such a system was established among BRI countries, would you support opening local currency business?

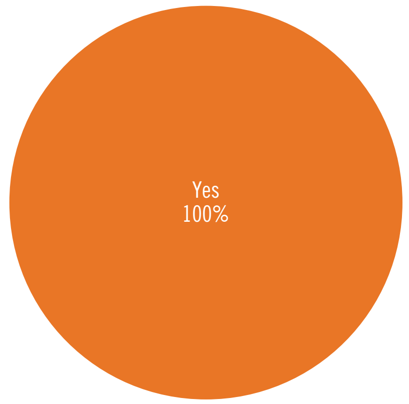


Figure 15 – Measures jurisdictions would take to avoid the spillover of financial risk brought about by the opening-up of local currency business

Region	1	2	3
Open local currency business, provide national treatment and control the total volume	18%	63%	18%
Open trade-related local currency business	55%	27%	18%
Partially open capital account business, including direct and securities investments, and control the total volume	27%	9%	63%

Votes were cast using a scale of 1–3, where 1 denotes the most urgent measure and 3 the least urgent.

In 2018, the euro was the preferred foreign currency, receiving 29% of the votes; the dollar and renminbi both received 19% of the votes. One explanation for this is a large number of BRI countries are emerging markets that rely heavily on US dollar funding.

The majority of central bank respondents also said they would support the establishment of a multiple, local currency payment and settlement system should BRI countries choose to establish such a system. Only 18% of central banks said they would object to such an initiative. Moreover, if a multiple currency system was established, all respondents reported that their institutions would be amenable to opening a local currency business (see figures 14 and 14a).

"We treat payment infrastructure as crucial for the successful implementations of projects under the BRI," said a large central bank. "We do pay attention to business in local currencies; at the same time, we admit market demand in payments in multiple currencies."

"The use of multiple currencies for payments will help to facilitate trade, and in that regard the central bank will be supportive," added one African central bank. "Central bank support, however, will be to the extent that banks are able to settle any long/short positions in a currency among themselves (or with their branches in other jurisdictions) without having to resort to the central bank."

To avoid the spillover of financial risk brought about by the 'opening-up' of local currency business, more than half of respondents to this year's survey ranked being "open to trade-related local currency business" as their top response, and another 27% as their second-placed option. Other strategies – as shown in figure 15 – comprised a partially open capital account, including direct and securities investments, while controlling the total volume (27% of first-place votes, 9% of second-place votes and 63% of third places) and open the local currency business and provide national treatment and control the total volume (18% of firsts, 63% of seconds and 18% of thirds).

1. *Belt and Road Portal*, International co-operation profiles, *https://bit.ly/2nJLiil*

2. *Organisation for Economic Co-operation and Development (OECD)*, Export credits work at the OECD, *August 2018, https://bit.ly/2uc6DEZ*

3. *Global Times*, Xi Jinping vows to promote China-Malaysia co-operation with Belt and Road, *August 2018, https://bit.ly/2Oa6Phh*

The 2018 Belt and Road Initiative (BRI) Survey

In 2018, the IFF, in collaboration with Central Banking, inaugurated the BRI survey. With responses received from 25 central banks from around the world, the findings concluded the BRI would bolster growth. However, more effective co-ordination was needed among member countries for the initiative to fully achieve its potential. The 2019 survey reveals the cogs of co-ordination are starting to turn, with expectations the BRI may flourish in an environment where traditional globalisation initiatives are beginning to crumble.
www.centralbanking.com/3456321

The Belt and Road Initiative

Birth pangs of a new world order

Globalisation has turbo-charged the world economy but increased social inequality and disparities in wealth. New challenges are emerging in the form of of populism and protectionism, and calls are increasing for a new system of global governance. *Sun Shilian*, of the Research Center on World Issues of Xinhua News Agency, and *Xiong Chai*, of the Center for Political Economy, Tsinghua University, report on a forum of international speakers at the IFF's 15th Annual Meeting in November 2018

IFF 15th Annual Meeting

Populism, unilateralism, trade protectionism and anti-globalisation are resurgent, and economic growth and global development face a new set of challenges in an increasingly risky landscape. Amid the chaos, China and other emerging economies are actively participating in the reform and construction of the global governance system, and China's efforts in promoting the Belt and Road Initiative (BRI) have received wide attention, approval and participation from the international community.

Crossroads of change

Society must embrace innovation for globalisation to be sustainable; advancements in technology will only be successful if implemented with a view to maximise productivity. While technological advancement has been the biggest driver of globalisation in the past, globalisation itself is now under threat.

Gloria Macapagal Arroyo, former president of the Philippines and now the country's speaker of the House of Representatives, said that since the establishment of the Bretton Woods system of monetary management led by the US in 1944, globalisation has advanced rapidly and profoundly. This has affected the development pattern of human society, especially since the fall of the Berlin Wall in 1989. However, in the past few years, new anti-globalisation and protectionist sentiments have emerged in the form of "America First" statements from President Donald Trump, and Brexit, the UK's decision to withdraw from the EU. Some pessimists even think economic globalisation has run its course.

Han Seung-soo, former prime minister of the Republic of Korea and former president of the UN General Assembly, believes the reason is that although the old idea of globalisation has brought many benefits to human society in economic and non-economic fields, the benefits have been uneven among and within countries. After the 2007–08 global financial crisis, during a period of slow recovery, instability and inequality – both social and economic – increased, leading to the rise of populism and protectionism.

Massimo D'Alema, former prime minister of Italy, reiterated that although globalisation has accelerated global economic growth in the past, it has also increased inequality and the concentration of economic wealth. The enterprises in developed countries moved to places with lower labour costs, resulting in damage to domestic workers' interests.

Zheng Zhijie, president of the China Development Bank, said international economic strength has evolved in a profound way, and the relative strength of the developed economies that created the traditional rules around globalisation has declined. Emerging and developing countries have comprised 80% of global growth, while only accounting for 40% of the total world economy. Currently, global economic growth faces severe challenges. Christine Lagarde, managing director of the International Monetary Fund (IMF), indicated that the global economy is being threatened by frictions on trade, which has cast doubt on the multilateral trading system.

José Manuel Durão Barroso, former president of the European Commission and former prime minister of Portugal, said we are living in different times. The mechanisms of the past have failed, but the new framework and new order have not yet arrived. We are in a transition stage and need to decide whether to have an open environment or a narrow, closed-off one. This uncertainty has triggered doubts in business and investment circles, and is the greatest risk to global economic growth at present.

Former Chinese vice-minister of finance Zhu Guangyao said the harm unilateralism and protectionism can cause was demonstrated in 2018, when long-established global supply chains came under fire. The open, transparent, inclusive and non-discriminatory multilateral trading system is now facing the threat of indefinite suspension.

Trend towards common development

Shaukat Aziz, former prime minister of Pakistan, said that despite differences in internal goals, all countries should look to co-operate to stabilise the global economy. The world has become more interdependent, and links between countries increase daily. Human beings must embrace globalisation if they are to prosper. "Only in this way can we ensure more competition, higher productivity and more active motivation for innovation," he said. "Worldwide, a new type of economic globalisation towards common development is gradually becoming the trend of the times and the common wishes of the people are moving towards it."

The longer globalisation stalls, the greater the damage. The Republic of Korea's Han called on world leaders to reverse the retrogression process. Harley Seyedin, special adviser to the chairman at the George H.W. Bush Foundation for US-China Relations, said US enterprises have suffered more than their Chinese counterparts in the trade friction between China and the US, and called for both sides to co-operate and cool tensions rather than expanding trade wars.

Anti-globalisation sentiment is not confined to one country. Barroso said that, although some people in Europe want to halt the process, the continent as a whole does not want to see globalisation stumble. He said it would be a bad decision for Europe to turn inwards and revert to the Cold War-era environment; the world needs a new institutional order. "It is necessary to establish a governance framework acceptable to and abided by all parties," Barroso said. He also emphasised that all multilateral institutions such as the UN and the World Trade Organization (WTO) should be supported to build infrastructure to continue improving the world's interconnectedness: "We must work together to achieve sustainable development, and we must not forget to help and support those less developed countries."

Former governor of the People's Bank of China Zhou Xiaochuan said that, compared with past globalisation efforts, new players and trends are now involved: the emergence of developing markets; the shift of investment-related savings from Western countries to emerging markets and Asian countries with high savings rates; the flow of information, trade and investment enhanced by technological progress; the gradual improvement of infrastructure and systems; and the joint response to a possible future global financial crisis. The focus of globalisation has changed, which should arguably create new rules and a new global consensus.

Globalisation is fuelled by investment and trade, international co-operation and the exchange of knowledge. Through optimising the allocation of resources among countries and the division of labour and co-operation, benefits can be reaped by all. In particular, low-income developing countries will benefit greatly, making global development more balanced, better and stronger.

A solution for globalisation

Since President Xi Jinping's proposal of the BRI in 2013, more and more countries and regions have supported and chosen to participate in its construction. China has signed co-operation agreements with more than 140 countries and international organisations, extending the reach of the initiative and creating opportunities for further projects.

Zhou believes the BRI will lead to the formulation of new globalisation rules. It has brought about a change in the scope and focus of globalisation, which will promote the formulation of relevant rules. But the new world order is still in its infancy, and should be strengthened through reform of the WTO and other international bodies.

Aziz said the BRI has set a new standard for global co-operation, which he hopes will be replicated by countries worldwide. Pakistan has already benefited greatly from the BRI with billions of dollars worth of investment. Ashfaque Hasan Khan, former finance minister of Pakistan and a member of Pakistan's economic advisory committee, related an old Chinese saying that prosperity depends on the prosperity of one's neighbours.

Arroyo said the BRI provides the hardware for a new type of globalisation and requires infrastructure for world trade and investments to thrive. This new type of globalisation will be more inclusive and will not be dominated by the countries of the West. The BRI can be interpreted as 'globalisation 2.0'.

Shakirudeen Adewale Oloko, Nigerian consul general in Guangzhou, said the BRI is also aiding development in Africa, offering a solution to tackle the wealth disparity caused by traditional globalisation. D'Alema also said he hoped the BRI will help with inclusivity and shared wealth. The BRI offers an opportunity for attracting investments and encouraging economic growth. However, there is also a concern China may reinforce its position in Europe, gradually shifting the balance of economic and political power in its favour.

The Belt and Road Initiative

In the footsteps of Marco Polo

Massimo D'Alema, former prime minister of Italy, notes that his countryman Marco Polo found hardship and conflict on his long route back from China to Europe, but that it was a price worth paying for co-operation and convergence

The Silk Road Economic Belt, connecting China to Europe via Central Asia. Italian explorer Marco Polo is believed to have travelled the route in the 13th century

Six years have passed since President Xi Jinping launched the Belt and Road Initiative (BRI) in 2013. It is changing the global status quo, and fuelling economic recovery and development in the countries along its route.

The Belt and Road Forum for International Cooperation, held in Beijing in May 2017, was attended by high-ranking representatives of 140 governments and 80 international organisations; China signed agreements with 80 of them. It is obvious that the BRI's importance extends far beyond economics, and marks a significant shift in the world's geopolitical equilibrium. It is therefore understandable the BRI not only has supporters and beneficiaries, but has also raised suspicion and opposition.

This certainly applies to the open hostility of the US administration; President Donald Trump views China as an adversary and is aiming to block China's expansion by means of a tariff war.

Conflict of interest

The European Union is apparently divided. Undoubtedly, the BRI offers opportunities for many European countries to attract investment and encourage growth in jobs. At the same time, there is concern that China may reinforce its position in Europe and gradually modify the balance of economic and political power in its favour. "Seen from Beijing, Europe looks like an Asian peninsula," German chancellor Angela Merkel said.

A few months ago, a problematic document critical of the Silk Road Economic Belt circulated among European ambassadors in Beijing. It described the project as conflicting with the European agenda of free trade, and capable of shifting the balance of power in favour of Chinese companies supported by state subsidies.

In other words, the EU worries – or at least some Europeans do – that co-operation with China will mainly benefit the Chinese because of the imbalance deriving from differing approaches to regulation and degrees of market openness. Luckily, due to US pressure – which is hostile not only to China but also the EU – the EU-China Summit in Beijing last July brought about an improvement in China-Europe relations.

Globalisation and its discontents

To understand the origin of the resurgence of nationalism and protectionism in the US and in some European countries, we know that globalisation has generated an acceleration in global growth. Worldwide GDP has almost tripled, from US$50 trillion in 2000 to $135 trillion in 2018.[1] According to International Monetary Fund data, it is expected to rise to $177 trillion in 2023.[2]

However, this impressive economic growth has not been reflected in parallel growth in prosperity for all. Some economies – including China's – have successfully explored all the potential of this process. Economic growth has been accompanied by social development, and in some cases by a dramatic process of emancipation, escape from poverty and expansion of the middle class.

At the same time, in many Western economies the effects of globalisation have been unequal, as data highlighting the increasing share of overall income received by the wealthiest segment of the population reveals. For a minority of the population – those belonging to the financial and educational elite – globalisation has offered an excellent opportunity that has been quickly embraced. For the vast majority, the process has been one of expropriation.

In 2016, 23.5% of the EU population was at risk of poverty or social exclusion. In absolute terms, this is 118 million people.[3]

However, it is not only a matter of poverty – although this is, paradoxically, growing even in times of economic expansion. While financial wealth has become increasingly concentrated, the power of labour has become weaker and weaker. The effect of global competition, which attracts many factories and business to where labour costs are lower, has led to the stagnation of wages, growing unemployment and the rolling back of rights and guarantees compared with the standards previously considered normal in the West, particularly in Europe.

At the same time, it has become more difficult for the public purse to pay for welfare and pension systems, partly because the progressive taxation systems that once allowed a significant degree of income distribution have been undermined by the free circulation of global capital.

It is therefore understandable that fear and bitterness are spreading in the most vulnerable sections of society, and we are seeing the success of political forces hostile to globalisation that preach the closure of borders not only to immigrants, but also to foreign goods.

Some theorists maintain that the European political scene, dominated for more than a century by the conflict between progressives and conservatives, is now occupied by the battle between globalist and sovereigntist, with the prospect of a shift in the continental political balances that could lead to unrest. Aggressive nationalism and protectionism are not solutions; on the contrary, they risk serious conflicts and the exacerbation of social problems.

However, even those who believe globalisation is an unstoppable trend should not underestimate the magnitude of the antipathetic forces currently brewing. Since 2008, it has been clear the neoliberal logic of unregulated globalisation is no longer sustainable, and that political action is needed to steer the worldwide system towards a more harmonious globalisation that can protect the weakest members of society. Answers will not come from protectionism and selfish nationalism; equally, not everything can be left to the rule of market forces.

Today, setting these objectives may seem ambitious, even unrealistic, in such a conflict-riven situation. A realistic strategy is necessary between the most farsighted and responsible market players, capable of realising true co-operation.

It is important to work towards improving the quality of EU-China relations, and the BRI's contribution to a higher level of co-operation on the Eurasian continent, which would inevitably also lead to benefits for Africa.

Massimo D'Alema

Strategic partnership

The BRI is a great opportunity for ensuring co-operation, rather than scepticism and hostility, can prevail. Doubts and uncertainties can and must be overcome. The faster China's authorities are able to make the necessary decisions, the faster this will be achieved. The keywords are reciprocity and co-operation. The EU must, in the final reckoning, view partnership with China as a strategic choice, not a policy to be left to the individual countries.

China, on the way to becoming the world's greatest economic power, can no longer expect to enjoy the safeguards and guarantees of a developing country. Three crucial aspects may be particularly significant. First, a strategy for Chinese investment in the EU agreed with authorities and tied in with EU development, strategies and priorities. Second, more openness in the Chinese market, especially in services, which may at least partly compensate for the trade imbalance now so strongly in China's favour. Last but not least, greater dialogue and co-operation on the political and cultural level to remove prejudices and promote understanding of our respective public opinions.

The BRI creates a great opportunity to make these changes; since the beginning, I have been a strong supporter. In 1271, Marco Polo set sail from Venice with his father Niccolò and his uncle Maffeo. He came to Khanbaliq – what is now known as Beijing – after crossing Palestine, Turkey, Iraq, Iran, Afghanistan and Guangzhou. After meeting Kublai Khan, he made his way home along the lengthy route into China, Malaysia, India, Oman, Yemen and East Africa.

Along this route there are also fears and conflicts. Bringing peace and development along the BRI is a great mission that cannot be left to China alone. At the other end of the route is Europe, which must be encouraged to rise to its responsibilities. Italy can and must play an important role.

As President Xi has stated, China and Italy represent two ancient civilisations that have known and respected each other for thousands of years. Now, more than ever before, we must work together.

1. *World Bank Data, https://data.worldbank.org/indicator/NY.GDP.MKTP.KD*
2. *International Monetary Fund,* World Economic Outlook Database, *April 2018, https://bit.ly/2Hc7MFZ*
3. *European Commission, Eurostat,* People at risk of poverty or social exclusion, *May 2018, https://bit.ly/2MB1AcS*

The Belt and Road Initiative

The futures game

China should open up its futures market to foreign participants, and its partners in the Belt and Road Initiative should escalate their involvement in futures markets to co-ordinate critical commodity supply and improve the stability and effectiveness of the whole initiative, writes *Jiang Yang*, IFF vice-chairman and former vice-chairman of the China Securities Regulatory Commission

Trading and settling futures, such as cotton and yarn, can be a platform to identify products that can promote further collaboration with other BRI nations

Most of China's bulk commodities trade comes from the countries bordering the Belt and Road Initiative (BRI). These countries are growing rapidly and possess exceptional development potential that can lay the foundations for win-win co-operation. In 2017, the total trade volume between China and the BRI countries was around US$1.3 trillion, accounting for almost 40% of the world's total. There are three commodity futures exchanges in China, and more than 50 varieties of commodity are currently listed, most of which are traded with countries along the BRI.

Infrastructure and future logistics

Transportation is a vital link in the delivery chain from futures to actuals; the inconvenience of shipping goods could also lead to market cornering. Chinese entrepreneurs have co-operated with the countries along the BRI to upgrade the infrastructure and enable the smooth flow of goods. A drop in the logistics cost of commodity trading will benefit the development of futures markets as a platform for countries to better integrate into the BRI.

The futures market provides a place to exchange all kinds of information; by observing the day-to-day transactions, and changes in price and hedging, countries will better understand China's political and economic situation, which will contribute to information connectivity and mutual understanding.

The logistics cost of commodities trading will be greatly reduced. With well-equipped transportation infrastructure and lower costs, countries along the BRI will develop stronger economic ties with China and consequently establish more links in broader fields. In this instance, the characteristics of the futures market will manifest themselves in the best light: rapid dissemination of information, a wide range of influence and a loyal and cohesive customer base.

There are four types of futures market co-operation with countries along the BRI:

1. China and some countries along the BRI list and trade commodities as actuals and in established futures markets. There are 22 different futures products traded – including palm oil, silver, fuel oil, natural rubber, cotton and cotton yarn – all of which are vital to daily life. Preliminary co-operation with Malaysia, Singapore and other coastal territories has been established, and futures trading and settlement is a platform to identifying common products for further collaboration. In 10-year, 20-year or even longer-term collaboration in business ventures, bank loans and insurance, futures trading would co-ordinate various resources that are critical to the BRI and will improve its stability, safety and effectiveness.

2. Other commodities have already been listed on China's futures market and have entered into actual trade markets, but have not yet been listed on the futures market of other countries along the BRI. China will work with exchanges in these countries to facilitate commodities listing or attract investors to directly participate in the Chinese market.

3. Some countries do not have established futures markets, although their commodities are listed in China's futures market. In the Middle East, for example, only Dubai has a crude oil exchange, at the Dubai Mercantile Exchange, in a joint venture with the Chicago Mercantile Exchange. Although Saudi Arabia exports the most crude oil in the region, it has not yet established its own futures exchange. China relies heavily on crude oil imports, with 60% of its demand coming from abroad. If a crude oil exchange in Saudi Arabia could become successful and mature in China's futures market, it would attract large investment, bringing benefits to both China and the Middle East.

4. Some commodities are traded in the futures markets of the countries along the BRI, but are not yet listed on China's futures market. We will explore possibilities for co-operation over these commodities.

These four categories of commodity all have potential for deeper co-operation. Because our futures market has not opened up enough to the world, and foreign investors have only minor involvement in the domestic futures market, China's futures market cannot at present set the pricing benchmark for global commodities and earn its place at the centre for risk control in the global economy. Openness can be increased by efforts in the following three sectors.

Legal framework

Overseas investors who participate in China's futures market attach great importance to the legal system. There is, however, currently no 'futures law' or other provision to regulate market participants' behaviour in China, and this is the major obstacle to openness to the rest of the world. After the listing of Shanghai crude oil futures, industry insiders and commodity customers said China must expedite the enactment of a futures law to open itself up and internationalise Shanghai crude oil futures to make them globally acceptable in pricing. Equipping foreign investors with laws to settle disputes will enhance their confidence in participating in the market.

Overseas investors are passionate about trading many commodities in China such as iron ore, steel and rubber, but the dearth of regulation impedes investment and undermines investor confidence. If the futures law is put into effect, major financial institutions and customers will flock to the market, ensuring the stability of market pricing and strengthening of the hedging function. As a result, there is a possibility that the price manifested in the futures markets will be internationally accepted as the pricing benchmark.

When the price is widely accepted in international trade and renminbi is used for transaction settlement, the desire to hold renminbi in the long term also increases. Renminbi will have an important role to play when it is used by countries and enterprises to buy oil assets all over the world and numerous commodities will exist to support renminbi internationalisation. Conversely, if these commodities do not internationalise, people will not hold renminbi for long. Without the futures law, it will be difficult for China to impose global influence on commodities pricing, which would be detrimental to national economic security.

Jiang Yang

New openness in the futures market leads many Chinese people to fear contagion from overseas financial risk. Since the 2007–08 financial crisis, a negative impression of financial derivatives has persisted. There has been clamour for restrictions on foreigners entering the Chinese market and curtailing of Chinese involvement in financial derivatives exchanges abroad. In fact, the financial crisis arose in the over-the-counter derivatives market, not the futures market, the risk management ability of which received significant recognition at the 2009 Group of 20 summit. Currently, the risk management of China's futures market is relatively mature, and has passed the risk assessments twice conducted by international financial organisations, which also rated China's risk control mechanism and 'penetration' method of supervision highly, and recommended them to other countries.

China's futures market has the capacity to control the risk brought by foreign participants. At present, markets for crude oil futures, iron ore and terephthalic acid are open and running smoothly. A relatively overarching risk prevention and monitoring mechanism has had remarkable results controlling risk and rooting out market manipulation and misconduct. During the financial crisis, China also stood strong against the contagion of risk from abroad.

Policy

The authorities should design co-ordinated policies in foreign exchange and customs, and lift certain entry bars for foreign investors entering the Chinese market.

Enterprises

Outward-looking enterprises should use various financial instruments comprehensively, including the stock index futures market. 'Going Out' requires that enterprises should not only use the static thinking of actuals to manage the risks of enterprises, but also manage the risks through dynamic development in futures.

The Belt and Road Initiative

Made in China – The new globalisation

Despite rumbles of populist dissent, *Ma Rupei*, former deputy director of the Overseas Chinese Affairs Office of the State Council of the People's Republic of China, believes globalisation remains irreversible and that China and its neighbours bordering the Silk Road Economic Belt are spearheading a new, more equal round of global growth and co-operation

Ma Rupei

The Silk Road International Association (SRIA) was inaugurated by former major policy-makers, financial experts and scholars from countries involved in the Belt and Road Initiative (BRI) in 2016 at the 13th Annual Conference of the International Finance Forum. International and domestic private capital has also played a crucial role from the beginning.

The establishment of the SRIA has injected new vitality and vigour into the BRI. Over the past three years, the SRIA has become increasingly influential in building pragmatic co-operation and fostering financial strength. Yet global economic growth and the development of globalisation face strong headwinds. The SRIA's mission and responsibilities are particularly important, and its march forward will be long and arduous.

In the second half of the 20th century, globalisation enjoyed explosive growth in trade, production, finance and labour thanks to the rapid development of the IT revolution and the widespread dissemination of value chain theory. The interactions and mutual influence powerfully unified the global economy and finance. Globalisation established an efficient international division of labour, realised the optimal allocation of production factors, promoted the integration of international interests, accelerated the trend of a multipolar world, strengthened the development of international organisations and reshaped the global governance system.

Traditional economic globalisation, however, also has its drawbacks: above all, the way in which it distributes its benefits inequitably. Some developed countries have dominated the traditional process of globalisation yet failed to manage relations between the interests of their own sovereignty and the global public interest. In the wake of the 2007–08 financial crisis in particular, global economic growth lacked momentum, economic globalisation slackened and – even worse – anti-globalisation emerged. Influenced by such slogans as "America First", trade protectionism and unilateralism sprang up. The global governance system, without an overarching global economic and political order, could not keep abreast of this development.

Shaping globalisation features

Anti-globalisation has occurred only regionally and sporadically, although its negative impact on the global economy should never be underestimated. Economic and financial globalisation may have changed, but it remains irreversible. Emerging economies now have a greater impact on its progress. For example, the Asia-Pacific region shows the greatest potential in its strong desire for development, openness and co-operation, and it is widely recognised as the current engine of global growth. The multilateral trading system brings common opportunities to all countries. As countries become increasingly interdependent, the global supply, industrial and value chains become closely intertwined, forming a community with a shared interest and future for mankind.

Following the path of a new type of globalisation is the right choice. Emerging economies, including China, have contributed to this new incarnation of globalisation, helping its features take shape: equal-footed co-operation for mutual benefit and win-win outcomes for all countries, greater tolerance of global trade and investment, innovation-driven development for new growth points, balanced development for a multicurrency pattern, and inclusivity and openness for fairer and more reasonable global governance. The SRIA values the following aspects in shaping the new type of globalisation:

1. **A Chinese template.** To develop green and inclusive finance, enhance financial credibility and facilitate new globalisation, China must demonstrate better performance in different financial dimensions: greater financial capital, more advanced financial technology, more comprehensive regulation, improved infrastructure and continuous financial innovation. We can surely deliver positive energy to globalisation by setting out on the right path, assembling and drawing on past experience and delivering positive effects. China must always put honour and integrity at the forefront of international co-operation; adopt a people-oriented, Silk Road-based concept; and create more professional, convenient, efficient and first-class green financial services. The SRIA should offer suggestions for a safer, fairer and more prosperous BRI economy by using its wisdom and academic power.

2. **Leveraging the Silk Road Economic Belt.** Concentrating on the key areas of industry, trade and infrastructure, China should direct international financial institutions to add impetus to the Silk Road Economic Belt and socioeconomic development in accordance with the five connectivity principles of policy, infrastructure, trade, finance and people. The Silk Road Economic Belt, with a population of nearly 3 billion, boasts large market scale and potential. The countries along the BRI adhere to the spirit of peace, friendship, openness, inclusiveness and mutual benefit in multilateral and upper-level exchanges, and fully demonstrate their strong aspirations for development.

   The Silk Road Economic Belt is the longest and most promising economic corridor in the world; to its east stands the Asia-Pacific economic circle, and to its west the developed European economic circle. Nevertheless, the region through which the Silk Road Economic Belt winds is challenged by poor transportation, a disadvantaged natural environment and uneven economic levels.

   To ensure the healthy and sustained development of the Silk Road Economic Belt, the SRIA should make full use of financial leverage, especially in emerging economies. It is imperative that it actively encourages and assists international financial institutions to engage in the development of industries, trade and infrastructure in countries along the Silk Road Economic Belt. The SRIA should also strengthen financial co-operation, including in currency circulation, currency swaps, clearing systems and the settlement of local currencies. Harder work is needed to optimise the allocation of production factors, and continued efforts must be made to promote trade and investment facilitation, deepen economic and technological co-operation, and map out free-trade zones.

3. **Technology counts.** An important task at this time is to follow the rapid development of new technology represented by big data, the internet of things, artificial intelligence, quantum information and genetic technology. Technological innovation has made the earth smaller. While multinational corporations have linked the world with industrial chains, pursued their interests to the maximum and optimised resource allocation, the contrast between prosperous and declining regions and industries remains remarkable. Prominent capital discrepancies remain, and the income distribution gap is widening. The current global governance system trails behind the process of economic globalisation and cannot stay abreast of the development of science and technology. Its future challenges include creating a fair financial playground and more institutionalised financial system, innovating financial services and products, formulating financial regulations, and forging balanced, inclusive and win-win development.

4. **Personnel resources.** Former Chinese nationals, Chinese citizens and Chinese students living abroad are three indispensable talent resources. They can steer international financial institutions towards helping financial enterprises to serve the real economy and financial capital to assist industry transformation, and upgrading financial industry to advance economic development.

   There are more than 50 million Chinese citizens and former Chinese nationals living abroad throughout the world, including more than 40 million in 66 countries along the Belt and Road. In 2017, the number of Chinese students studying abroad exceeded 600,000 for the first time.[1] This talent has advantages: familiarity with international societies and cultures, resource endowments, laws and regulations, cultural and historical development, and economic and social development of the country in which they live or study. This group has played an important role in taking Chinese companies global, and connecting China with the world economy in the process of China's reform and policy of 'opening-up'. With a wide range of political contacts, good communication channels in host countries, and fine industrial strength and social networks, their important role – once maximised – can generate unprecedented positive energy. They can connect finance to the real economy, give feedback by hearing public opinion, explore the financial channels for product implementation, provide policy consultancy and advice on how finance can create wealth, and serve as a financial think-tank to offer financial services.

Expo of the future

Last year marked the 40th anniversary of China's reform and opening-up. President Xi Jinping attended four consecutive major diplomatic activities hosted by China, where he elaborated on the concept of the community with a shared future for mankind, provided Chinese wisdom and added China's impetus to global development. The inaugural China International Import Expo (CIIE) in autumn 2018 aimed to intensify a new round of high-level opening-up, and epitomised China's decision to open its markets to the world. From 151 countries and regions, 3,617 enterprises participated in the expo, with the cumulative signed deals and intentions of the countries along the BRI totalling US$4.72 billion.[2] The success of the CIIE proves that, despite trials and tribulations in the process of BRI development, the road towards the new model of globalisation still displays great promise.

1. *K Kennedy, The Pie News*, China outbound student numbers at record high, *April 2018, https://bit.ly/2vuduwO*

2. *Global Times*, China International Import Expo ends in Shanghai, *November 2018, https://bit.ly/2T5zJRi*

The Belt and Road Initiative

Funding the new Silk Road

The Greater Bay Area excels in key areas that can strengthen financial co-operation, construct robust infrastructure and champion sustainable investment along the Belt and Road Initiative and worldwide, says *Luo Yang*, managing director of the Silk Road Fund

The Silk Road Fund (SRF) was established by the Chinese government to support medium- and long-term investment projects. It adheres to the concepts of openness, inclusivity, mutual benefit and win-win outcomes, and follows the principles of marketisation, internationalisation and professionalism. The fund aims to actively expand investment and financing co-operation opportunities by adopting as its mainstay miscellaneous investment methods with medium- to long-term equity investment, and supplementing this with loans and fund investments in collaboration with domestic and foreign investors. The SRF has already signed off more than 20 projects and pledged to invest more than US$8 billion, with the total investment involved predicted to be well beyond $90 billion. With total capital of $40 billion and RMB100 billion, SRF investments go toward infrastructure and energy projects, while fostering co-operation in in Russia, Central Asia, South Asia, Southeast Asia, Western Asia, North Africa and Europe. Investment may be extended to more regions in America and Africa in the future.

Most developing countries along the Belt and Road Initiative (BRI), though currently undergoing significant transformation, are in dire need of countless large-scale infrastructure and industrial capacity co-operation projects to underpin their economic development. Lacking financial strength and with inadequate external capital input, however, these countries rely on the market for long-term investment and require large amounts of financial support at reasonable cost.

Traditionally, most of their investment and financing services are provided by policy- and development-oriented financial institutions. The long-term sources of funds are structural investors such as sovereign wealth funds, pension funds and insurance companies, which are unwilling or find it difficult to finance those large-scale projects because of concerns over financial security and insufficient market mechanisms. To that end, it is necessary to strengthen financial co-operation and encourage financial innovation to better enhance the matchmaking between capital demanders and suppliers. The Guangdong–Hong Kong–Macao Greater Bay Area has much to offer naturally in infrastructure and development projects, particularly in the following three aspects.

1. A launchpad for co-operation

The Greater Bay Area is intensifying financial co-operation and building a platform for multiparty co-operation by leveraging its diversified strengths.

Developing countries are impeded by the shortage of financing for medium- to long-term projects, so BRI financial co-operation requires the joint participation of all stakeholders. Through the diversified co-operation of various regional institutions, all parties can see their benefits and risks better matched to assist developing countries in improving their ability in medium- to long-term sustainable development. Guangdong, with its handful of top-quality high-tech manufacturing enterprises, is a pioneer in reform and the policy of 'opening-up' in the Greater Bay Area, and can leverage its years of professional advantages in technology to invest in the BRI. As a huge capital market focusing on financial services, Hong Kong can act as a financial services provider and fund pool for large BRI projects. Macao, a bridge for communication and co-operation with Portuguese-speaking countries – such as Brazil and Mozambique – can assist backers to better understand the projects in these countries and, to a certain extent, arrange credit support for these projects.

Luo Yang

The SRF has been exploring various models to fund BRI development through multiparty co-operation. Since 2016, the fund – with development finance institutions such as the Korea Development Bank, Japan Development Bank and Asian Infrastructure Investment Bank – has been making investment in the World Bank's Asia emerging market fund, covering several projects in countries such as Bangladesh, India and Myanmar. Following the concept of multiparty co-operation, this fund brings Chinese, Japanese and Korean capital into third-party markets, providing impetus for the sustainable economic development and social progress of countries along the BRI. In the meantime, the SRF has maintained sound communication with Shenzhen investment institutions and the Hong Kong and Macao monetary authorities in the hope of providing better financial support for the BRI in the future. There remains much to do in integrating the financial institutions of the Greater Bay Area to jointly invest in the countries along the BRI.

Apart from collaboration with official financial institutions in Japan and the Republic of Korea, the SRF has also kept in close contact with companies and financial establishments in Europe and the US – including the European Investment Bank and General Electric. A memorandum of understanding was signed with the European Bank for Reconstruction and Development.

2. Innovation of renminbi products

The Greater Bay Area is driving forward with financial innovation, particularly in renminbi products.

The major reason behind financial shortfalls in large-scale infrastructure projects and industrial capacity co-operation is project risks are difficult to effectively control and mitigate, and are greater than the benefits. Since the SRF received a capital increase of RMB100 billion in 2017, it has been actively establishing renminbi investment projects overseas. The SRF also observed renminbi hedging instruments lasting three years or more are limited in number and high in costs, which makes it difficult for the medium- to long-term exchange rate risks of the renminbi to be effectively hedged. This, to a degree, restrains the willingness of overseas owners to accept renminbi investment. The Greater Bay Area, on one hand, fully uses its geographical advantages to encourage financial institutions to design targeted financial instruments and infrastructure solutions, continuously promoting innovation and improving market mechanisms. On the other hand, it has actively explored the construction of related projects with the public-private partnership model and, reinforced by equity investment, helped the country in which the project is located to reduce its debt burden, improve project construction and operational efficiency, and boost sustainable development.

3. Developing green finance

A key role of the Greater Bay Area is to bolster sustainable and green finance, and enhance the overall benefits of the BRI.

The international community has recently become more concerned with the social and environmental effects of economic development, and sustainable finance is increasingly recognised and respected by investors. There are two main reasons for this: first, countries are increasingly strict in regulating the environmental, social and governance (ESG) effects of projects; second, research shows that the ESG performance of most projects is positively correlated to long-term financial returns. Thus, many investors regard ESG as an important evaluation factor in the market, and seek out ESG-themed investment funds. Data shows there are currently around 600 funds in ESG-related fields worth approximately $200 billion, focusing primarily on healthcare, new energy, education and training. The Greater Bay Area is underpinned by new economic industrial sectors such as advanced manufacturing, the modern services industry and the international financial industry, all highly conducive to sustainable financial development. For this reason, firms should be motivated to highlight their projects' ESG performance, and guide project investors and implementers towards improving their corporate governance.

The SRF has always been an active champion of sustainable investment, concentrating on assessing projects' performance in environmental protection and social responsibility. The fund has partnered with the International Finance Corporation (IFC) – a member of the World Bank Group – and the China Three Gorges Corporation (CTG) to invest in the Ghazi–Barotha hydropower and wind power project in Pakistan in alignment with the China–Pakistan Economic Corridor. Bringing in the IFC's international standards and experience in corporate governance and financing construction, project leaders exercised strict control over the entire process of development, construction and management, to focus on fulfilling ESG concepts and standards. In addition, the project has elevated the international reputation of CTG. The SRF has been highly supportive of this model project, which has now been completed, with sound economic and social benefits.

Conclusion

As we have seen, these three aspects – building a multiparty co-operation platform, innovating renminbi products, and developing green finance – all hold great promise in improving infrastructure along the BRI. The SRF also looks forward to enhancing co-operation with the Greater Bay Area as well as other countries and regions to boost peace, stability and prosperity in the region and around the world.

Macao acts as a bridge for communication and co-operation between countries along the BRI and Portuguese-speaking territories

Beyond bilateral – The queue for CPEC

Not just a bilateral agreement between the two countries, the China–Pakistan Economic Corridor can benefit neighbouring countries and the entire region, says *Ashfaque Hasan Khan*, former finance minister of Pakistan and member of Pakistan's Economic Advisory Council

This year marks the sixth anniversary of China's Belt and Road Initiative (BRI) – a suitable opportunity to review what we have learned from it, and where we want to go. Perhaps, in four years – as we analyse the 10th anniversary of the BRI – we will be able to look back on the many obstacles we have surmounted in its development.

The old globalisation has come under attack in recent years. We have witnessed nationalism and protectionism in many Western countries – including the US – which carry the potential to hamper global growth and prosperity. There is nothing wrong with globalisation except the manner in which it was implemented, which has created these feelings all over the world.

In 2013, realising these problems, the Chinese leadership, with President Xi Jinping at the helm, took charge and launched the BRI – a new incarnation of globalisation. It is important to understand the Chinese saying about prosperity being dependent on your neighbours' prosperity – you cannot achieve prosperity in an ocean of deprivation and poverty. This is the governing philosophy behind the BRI, totally different from the old globalisation, which has led to massive income inequality across the world.

Corridor of power

The China–Pakistan Economic Corridor (CPEC), is the flagship and cornerstone of the BRI. It has the potential to transform Pakistan's economy from low to medium income to high income within the next 15–20 years. CPEC covers everything from energy and key elements of infrastructure, including roads, motorways, seaports and airports, to developing communication and several economic zones.

More than half of western China is geographically adjacent or close to Pakistan, the Arabian Sea coastline and Pakistan's deep-sea Gwadar Port. CPEC and Gwadar are significant because they will reduce 80% of the distance, 75% of the time and 70% of the cost when shipping from western China to the rest of the world.

Today, Gwadar has the capacity to handle approximately 1 million tons of cargo a year. By 2030, when the port is fully functional, it will have the capacity to handle 400–500 million tonnes and become one of the world's largest ports, generating huge amounts of economic activity in this part of the world.

Ashfaque Hasan Khan

CPEC has the potential to assist Pakistan in building its infrastructure and balancing its regional development. It has overcome the energy crisis in Pakistan, and it will lead to industrialisation and export promotion through the establishment of nine special economic zones, developing agriculture, services, mining and quarrying, as well as the port and city itself. CPEC will lead to millions of jobs and strengthen regional connectivity. Pakistan has already started witnessing these benefits thanks to CPEC, the cornerstone of the BRI.

CPEC sounds like a bilateral product, but it is an initiative for the whole region, not only between China and Pakistan. In the first five years, CPEC has concentrated on Pakistan, but within the next five or 10 years, CPEC should be made a truly regional initiative. But how it can be done?

A regional powerhouse

Another regional bloc is the Central Asia Regional Economic Cooperation Program (Carec). Its 11 member countries include Afghanistan, Azerbaijan, China, Georgia, Kazakhstan, Kyrgyzstan, Mongolia and Pakistan, and a natural alliance exists between CPEC and Carec.

Carec is doing exactly the same thing as CPEC – promoting regional co-operation through transport, trade facilitation, energy and energy trade policies. This can be extended to bring Central Asia into the framework of CPEC, including – critically – Afghanistan, a neighbour of both Pakistan and China.

A road to the Gwadar Port, a cornerstone of the BRI

The extension of CPEC here depends on whether Afghanistan wants to fulfil its potential and reap the benefits. Afghanistan is a landlocked country that uses Karachi as its port; joining CPEC would be immensely beneficial as Gwadar – only 450km from the border – could serve as a second Afghan port.

Iran has also showed interest in becoming involved with CPEC. Today, the bilateral trade between Iran and China is about US$40 billion,[1] mostly in oil and gas. And Iran intends to enhance its trade with China to $600 billion over the next seven years.[2] This can only be possible if Iran takes advantage of CPEC and allows Gwadar and Chabahar to serve as sister ports.

Until 1985, Pakistan, Iran and Turkey were members of a bloc called the Regional Cooperation and Development Organization, and Pakistan continues to enjoy a very good relationship with these nations. Turkey could also take advantage of CPEC, and there is also a possibility that Russia could join CPEC to use Gwadar.

The BRI and renminbi internationalisation

China must prepare for the renminbi's ascension to being the primary global currency. It has already taken the initiative in this direction and entered into a currency swap arrangement with 33 countries.

In the next decade, we will enter into a multiple-reserve currency system. The US dollar will remain one of the reserve currencies, but the renminbi will emerge as the single largest. In such a new environment, with Asia emerging as the leader of the world economy, new global financial architecture will be required.

Today, if any developing countries face a balance-of-payments crisis, they can go to the lender of the last resort for bailout, in this case the International Monetary Fund (IMF). As China's BRI continues to grow and convince more countries to join, there is a need for the regional monetary system to support and complement the efforts of the IMF.

The world economy is expanding rapidly, and the IMF on its own may not be able to do justice to developing economies in the event of financial crises. Other initiatives have sprung up to support it. We have seen this in the establishment of the World Bank, one of the Bretton Woods Institutions, and the emergence of the Asian Development Bank in 1966, followed in 2016 by the Asian Infrastructure Investment Bank (AIIB). The World Bank cannot be expected to support the agenda of many developing countries, thus the Asian Development Bank came to the fore as an institution. Now, with the advent of the BRI, the AIIB is expected to play its role.

There remains a need for a regional monetary fund to supplement or complement the efforts of the IMF to maintain a stable global financial system. Maybe in four years' time when we celebrate the 10th anniversary of the BRI, more countries will have joined – this is my hope and my prayer.

1. *Financial Tribune*, Iran's trade with China rises to $19.6 billion in H1 2018, *September 2018, https://bit.ly/2QN2HDq*

2. *Dawn*, Iran, China agree $600-billion trade deal after sanctions, *January 2016, https://bit.ly/2SOX8pX*

The Belt and Road Initiative

Partners in progress

Many countries neighbouring the Silk Road Economic Belt are eager to participate in China's ongoing infrastructure and co-operation drive. Five diplomats based in the hub of global integration Guangzhou and the IFF's vice-chairman share their views of their respective participation in this vast project, and their hopes and concerns for the future

Sultan Bin Nasser Al Suwaidi
IFF vice-chairman and former governor of the Central Bank of the United Arab Emirates (UAE)

The Belt and Road Initiative (BRI) will enhance not only contacts between people but also economic and financial inclusion, which is the UAE's area of speciality within the global central bank community.

It is important for countries participating in the BRI – especially in Africa and Central Asia – to lay the groundwork for the financial infrastructure that could facilitate capital flows. Three objectives must be met: regulation, implementation and openness in financial services.

Clear and transparent rules and regulatory institutions accessible in any country are also required. Regulation requires a corresponding sponsor within the country, otherwise they are of no use. A specialised institution needs to be established to tackle regulatory problems for both foreign and domestic investors.

But regulations alone are not enough; the implementation process is more important. Large sums of money in developing nations disappear because no secure infrastructure exists to receive and invest local deposits, and foreign investors cannot repatriate their money and reclaim their profit. It is a prerequisite that countries participating in the BRI must devise a mechanism to alleviate this.

Openness in financial services requires the following:

- A mechanism for issuance and approving of unit trusts or mutual funds, especially those that would provide financing for small businesses.
- Venture capital for companies with good ideas but limited or no access to finance.
- Development of local bonds markets. The markets serve business at all times – when there is a crisis, people need to go to the local bonds market and get funds. Business may continue rolling without the ability to issue bonds in the local currency, but it will be difficult to expand, and difficult for countries to mitigate the forces of a global financial crisis.

Shakirudeen Adewale Oloko
Consul general at the Nigerian Consulate General, Guangzhou

Nigeria officially signed up to participate in the BRI in September last year, but the country has a far older relationship with China. Nigeria – and Africa as a whole – recognises it could reap huge benefits from the BRI. Forty years ago, many of China's huge population lived in poverty, but reform and the policy of 'opening-up', and the surge of infrastructure development have clearly moved people out of poverty to achieve what we see today. It is in this light that the BRI is regarded as a development strategy.

In Nigeria, the railway from Lagos to Ibadan was constructed by Chinese corporations. It will eventually extend further to the north and south, and link up with the east–west line. The BRI is also investing in facilities and infrastructure on the roads between Lagos and Abuja.

Electricity is an important part of the BRI. The president of Nigeria, Muhammadu Buhari, visited Beijing in September 2018 and entered into discussions with President Xi Jinping. The Export-Import Bank of China is studying the provision of financial support to the projected Mambilla hydropower project to allow it to provide electricity to Nigeria.

Admiration can go hand in hand with suspicion and doubt, however. Financial support and infrastructure development brought by the BRI to Africa has led to much discussion by opinion-makers and experts that it may lead to a debt trap.

In Africa, globalisation has been controversial. It was not well received and the impact was obvious to all: income inequality and poverty. Africa needs trade rather than aid. Only when one can fully participate in the global system is it time to talk about development. It will be usual for developed countries to continue to dominate the discussion, and perhaps the BRI will go a long way to solving these problems associated with globalisation.

For now, Nigeria believes the BRI can bring back economic progress and – most importantly to developing countries – bring more development, better provision for the people, more employment and less poverty. The BRI can help provide the necessary economic lift-off and could advance people to a better life, as has been successfully demonstrated in China itself.

Chinese policy-makers should note that domesticating the technology introduced to Africa will provide employment opportunities here. People will be more supportive when they see improvements to their livelihood, income and prospects.

It is crucial that recipients of financial support for infrastructure development estimate and understand their capacity to pay it back, rather than mortgage the future. International finance will always look for returns. It should be agreed that development and growth is shared, and nobody will be left behind – this would be real progress. The China International Import Expo in Shanghai last year was a good example of revealing the opportunities other countries will have to export to and reduce trade imbalances with China. Countries do not use their foreign exchange to pay debts while embarking on the path of development.

It is important we look at what the BRI has achieved in the past five years, and anticipate where it will be in the next five. When its 10th anniversary is celebrated, it will not be a recommendation or condemnation of the whole process, but a celebration of those development successes and positive outcomes.

Adam Yousif
Consul general at the Sudanese Consulate General, Guangzhou

The BRI aims to bring peaceful economic co-operation and development to all participating nations. In response to the crippling crises and economic faultlines of today, the BRI offers an abundance of alternative applications to benefit the world economy as a whole.

It is introducing co-operation, not conflict; honourable, not aggressive, competition; and openness, not introversion. The BRI also brings cultural co-operation, which will be important to bring the world community together. It is very important all participants in the BRI feel it is made for them – that everyone should aim for a win-win situation – the BRI is not an initiative built only for one party. A Chinese saying truly reflects this win-win relationship: "Your prosperity depends on that of your neighbours."

Sudan is at the heart of the BRI route: to the north and west it serves as a gateway from Asia into Africa; to the east lies the Red Sea. In a way, Sudan connects north-east Africa with Europe. In Africa we attach great hope and importance to the BRI and believe it will carry us forward to greater development. The success of the last summit of the Forum on China–Africa Cooperation in November 2018 proved a great leap toward further economic co-operation and implementation of the BRI.

Issues around debt are a pressing topic in any discussion about the BRI. It is a very real problem – although it varies between different countries and regions – and should be avoided. The cause of debt in Africa is more obvious. We need to look closely at the past, learn from experience and forge new economic relations in the spirit of general co-operation. Debt and its pitfalls should be addressed and discussed and lessons learned in order to press on with making a success of the BRI.

Maksat Ishenbekovich Tentimishov
Consul general at the Kyrgyz Consulate General, Guangzhou

Kyrgyzstan and China have maintained friendly relations since ancient times. Three branches of the ancient Silk Route passed through the territory of what is now Kyrgyzstan, which contributed not only to trade but to an active exchange of culture and values between the Kyrgyz people and other countries. One of the symbols of historical and cultural ties between Kyrgyzstan and China is Li Bai – the greatest Chinese poet of the Tang dynasty – who was born in the ancient city of Suyab, in the north of Kyrgyzstan.

Kyrgyzstan and China are good neighbours and strategic partners. Since the establishment of diplomatic ties, both countries have witnessed sustainable and healthy development of bilateral relations.

Kyrgyz president Sooronbay Jeenbekov's successful visit to China has further consolidated the friendship and trust between the leaderships of the two countries. During this visit, President Xi and President Jeenbekov mapped out the future development of bilateral ties.

Kyrgyzstan and China are founding members of the Shanghai Cooperation Organisation (SCO). According to the SCO's framework, the heads of state meet once a year, as do the heads of government, to discuss outstanding bilateral issues.

China is one of the principal economic partners of Kyrgyzstan and the nation's primary foreign investor. China has financed numerous projects in Kyrgyzstan in infrastructure, energy and mining. It is our largest lender and the source of much development finance; current projects include the Kyrgyzstan–China gas pipeline, a north-south highway and the construction and repair of roads in the capital, Bishkek.

The Silk Road Economic Belt, part of the BRI, was proposed by President Xi during his first visit to Kyrgyzstan in September 2013. Kyrgyzstan fully supports the BRI, and our positive response can be easily understood. It offers huge and much-needed economic opportunities to Kyrgyzstan. We are confident that the willingness of the Chinese leadership to advance its regional integration will have significant ramifications for Kyrgyzstan in particular. The two countries' economies complement each other: China has advanced technology and financial systems, whereas Kyrgyzstan has resources and is a good base for further beneficial co-operation.

The government of Kyrgyzstan is willing to strengthen practical co-operation with China by making a net contribution to the construction of the BRI.

At the 2017 Belt and Road Forum in Beijing, President Jeenbekov noted the importance of expanding the fibre-optic communication lines from China to Europe as well as Kyrgyzstan's e-commerce and the creation of logistics centres.

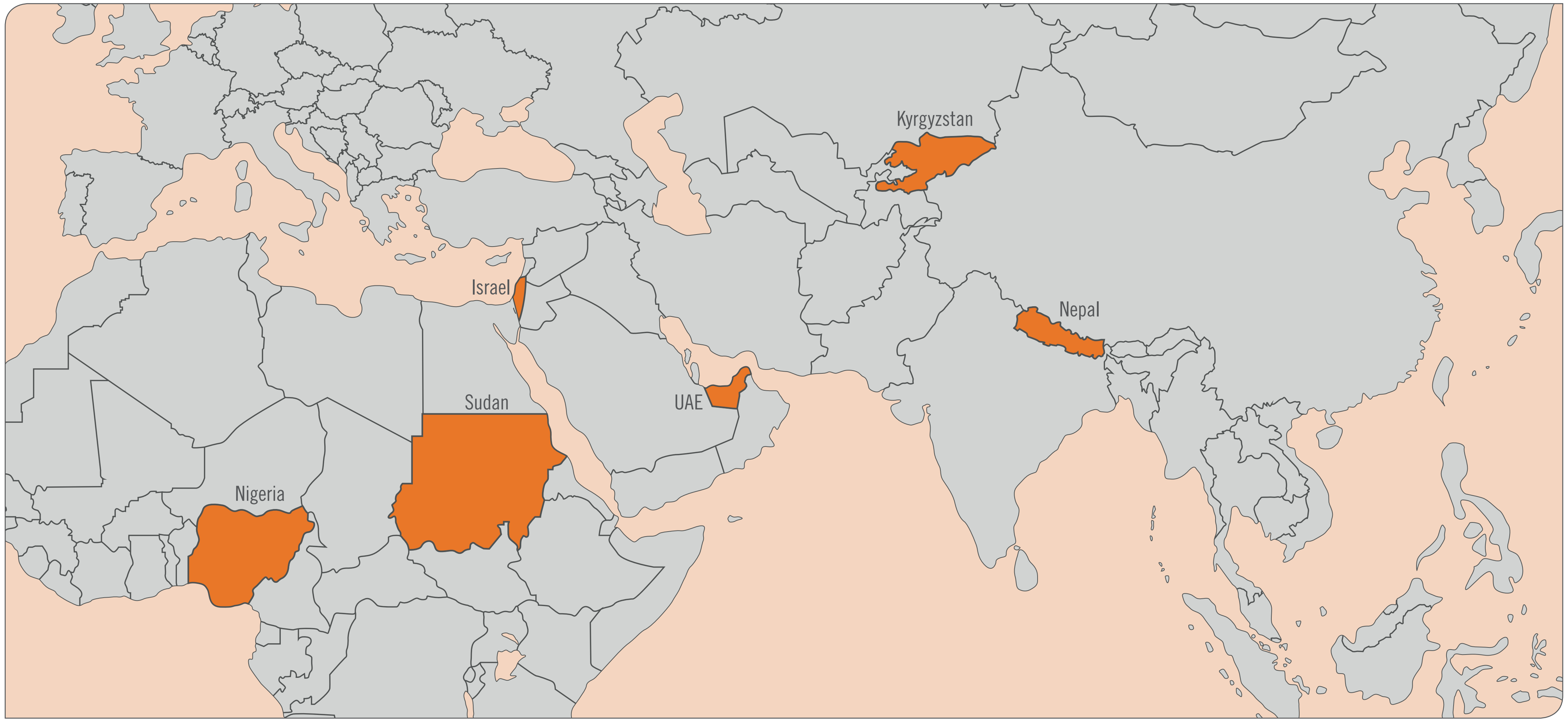
As the BRI intends to connect Asia, Europe, the Middle East and Africa with transportation systems and a vast logistics effort, the government of Kyrgyzstan hopes a China–Kyrgyzstan–Uzbekistan railway project – which would further develop trade relations between China and Central Asia – will be included in the BRI framework. Kyrgyzstan attaches great importance to this project and endeavours to push it forward.

The construction of hydropower stations and the production of clean energy is a very promising sphere of Kyrgyzstan–China BRI co-operation. Kyrgyzstan has huge hydro potential, generating 150 billion kilowatt hours of electricity per year. At present, only 10% of this potential is tapped but but Pakistan, which faces electricity shortages, could be a big importer in the future.

At this moment, Kyrgyzstan and its neighbours in the region are developing hundreds of projects to export electricity to Pakistan. Electricity transmission networks are being built between Kyrgyzstan and Pakistan, Tajikistan and Afghanistan. Construction is expected to be completed in 2021, and the export of surplus hydro-electricity to Pakistan will begin. The government of Kyrgyzstan continues to seek Chinese investment for the construction of hydropower stations to meet Pakistan's electricity demand.

It is important to note that Kyrgyzstan has 6 million inhabitants, but trades in a market of 180 million. This is the common market of the Eurasian Economic Union (EEU), of which Russia, Armenia, Belarus, Kazakhstan and Kyrgyzstan are members. Free trade without customs duties is the major advantage here. A Chinese businessman entering Kyrgyzstan claims the opportunity to enter the common market of the EEU. The government of Kyrgyzstan therefore welcomes Chinese investment here to take advantage of the country's low cost of power, labour and land, and to meet the demand for Chinese goods across the EEU countries.

In conclusion, the bilateral relations between China and Kyrgyzstan will only become more effective and efficient within the framework of the BRI to the common benefit of the people of both countries.



Dipak Banjade
Acting consul general at the Nepalese Consulate General, Guangzhou

Today's political environment is susceptible to a ripple effect, where events in one place can easily influence events elsewhere, to the extent of having an impact on the other side of the world. The Tunisian revolution in 2011 was arguably the stimulus to the Arab Spring uprisings, thanks in part to the media and internet, which have rapidly increased the speed at which information travels. The growing interconnectedness of our world means globalisation is both a friend and foe.

China has emerged as a pre-eminent economic and political figure. Every step China takes has an impact on the rest of the world. The BRI is generally welcomed by the rest of the world; in parts of Africa and Asia, many expect the BRI to ignite their own country's growth prospects by increasing investment and new technology streams to infrastructure projects there.

While success is not assured – and some countries worry about China's advancing grip on the world – the BRI's wide reach is making a positive impact. Many countries want to benefit from these kinds of initiatives, which suggest a more 'mature' form of globalisation is possible.

So why is the BRI important to Nepal? The prosperity of one country's neighbours can impact a country's own prosperity. Underdeveloped Nepal sits on the south-west border of China, and wants to benefit from China's success. but growth opportunities for Nepal are limited given its geographical location – landlocked, sandwiched between China to the north and India to the south. Connectivity as a result is poor, making the transportation of goods and services difficult.

We hope the BRI will bring forth a better world, one that enables Nepal to grow. There are currently numerous rail initiatives taking place as part of the BRI, and we hope this will eventually lead to a railroad link between Nepal and China. Not only will this benefit our two countries, but Nepal could in time become a bridge between China and India. If China and India can facilitate economic relations via Nepal, we hope to become a prosperous country within the region.

Nadav Cohen
Consul general at the Israeli Consulate General, Guangzhou

Bilateral relations between Israel and China are improving all the time. Israel today enjoys a very special relationship with China in economic co-operation and high-tech innovation.

Israel fully supports the BRI, which has seen Chinese companies take on major infrastructure projects in Israel. One Chinese company has constructed the new terminal of Israel's biggest seaport, the Port of Haifa, and another operates the new northern seaport at Ashdod. Another two work on the infrastructure of the light rail system in the main business city of Tel Aviv. Building on these foundations, the Israeli government has invited the Chinese government to escalate the number of projects China will partner Israel in. The BRI is a vision to fulfil over the next 30 or 50 years, so these first five years have only been the first phase – not perfect but a very good start.

Israel and China can conduct more bilateral projects in the interests of both countries. Furthermore, Israel believes the two nations can conduct trilateral projects in other countries, along either the Silk Road Economic Belt or the Maritime Silk Road. In its 70 years of independence, Israel has gained rich experience of developmental projects in emerging economies, and regional co-operation with our neighbours. Israel can make a valuable contribution to upcoming BRI projects.

FINANCIAL DEEPENING, FINTECH DEVELOPMENT AND GREEN FINANCING

Financial deepening, fintech development and green financing

A journey with no end

China celebrated the 40th anniversary of the inauguration of its campaign of reform and 'opening-up' last year and, despite its many successes, there is no reason to begin applying the brakes yet. *Sun Shilian*, researcher at the Xinhua News Agency World Research Centre, and *Xiong Chai*, at the Center for Political Economy, Tsinghua University, report from an IFF-led forum on China's continual reforms

As globalisation approaches a critical juncture of change, and world economic growth faces severe challenges, it is clear the need for China's continuing reform and policy of 'opening-up' has never been greater. At the International Finance Forum's (IFF's) 15th Annual Conference in November 2018, participants discussed reform and opening-up on the 40th anniversary of the summit that launched China in a new direction.

Sun Shilian

Integration into the world

Zhou Hanmin, vice-chairman of the Municipal Chinese People's Political Consultative Conference (CPPCC) Committee of Shanghai, said China has been integrated into the world and has been the world's largest trading country for four consecutive years, contributing around 30% of growth to the global economy.[1] For China, reform and opening-up is a journey with no end, and further integration is always the goal. Since the Third Plenary Session of the 11th Central Committee of the Communist Party of China (CCCPC) in 1978, China has embarked on a great journey of reform, opening-up and socialist modernisation, and has made the leap from a low-income to an upper-middle-income country. The 40th anniversary was an opportunity to review the process, assemble the valuable experience gained and make insights into its significance to China's future development.

Zhu Guangyao, former vice-minister of the Chinese Ministry of Finance, said that, in the past 40 years, China's economy has grown from RMB367.9 billion in 1978 to RMB82.7 trillion in 2017 – an approximately 15-fold increase. Today, China's foreign exchange reserves exceed \$3 trillion, from US\$167 million in 1978. More importantly, the living standards of the Chinese people have improved significantly. In 1978, China's GDP per capita was only \$220, whereas in 2017 it exceeded \$8,800. China's economy has grown on average more than 9% over each of the past 40 years. These changes have benefited the Chinese people, and affected the world.

The key to success

Upholding and developing socialism with Chinese characteristics and continuing reform and opening-up have been the key to China's success in the past. Former president of the Philippines Gloria Macapagal Arroyo, now the speaker of the House of Representatives in the Philippines, first visited China in the mid-1970s and witnessed the four-decade process of this reform and opening-up. Arroyo said the great progress China has made is not based on the Western model of development, but the success of socialism with Chinese characteristics. China has grown into the world's second-largest economy and is set to become the largest. Arroyo believes the core definition of socialism with Chinese characteristics is the improvement of productivity through reform and opening-up.

The most important aspect of reform is the emancipation of the mind. Zhu Guangyao believes China's reform and opening-up is a great ideological liberation. Before the Third Plenary Session of the 11th CCCPC in 1978, at the closure meeting of the Central Economic Work Conference, paramount leader Deng Xiaoping made an important report on the theme of 'Free our minds, seek truth from facts, and unite as one looking to the future', which forged the consciousness of the whole party and the entire Chinese population in reaching consensus centred on economic development. Zhu Guangyao said 'Free our minds' is the most important and fundamental thought.

Reform laid the foundation for opening-up, which also promoted China's domestic reform. Before 1978, an economically isolated China implemented a highly centralised planned economy and had one of the lowest per capita incomes in the world. Zhou Xiaochuan, vice-chairman of the 12th Committee of the CPPCC and former governor of the People's Bank of China, said the opening-up process strongly impacted the traditional planned system, and provoked a series of major reforms, including reform of the price system, value-added tax, export tax rebate and exchange rate marketisation, and negotiations over the General Agreement on Tariffs and Trade and membership of the World Trade Organization.

The opening-up of the manufacturing industry has enabled China to become the world's factory, and many industries are moving towards the middle and high end of the global industrial chain. Moreover, most industries that participated in the early opening-up and introduction of competition have shown rapid growth and strong competitiveness. The opening-up of the services industry reflects a similar pattern: introducing competition through opening-up to the outside world, promoting the improvement of business efficiency and service quality, and spearheading the reform of relevant domestic policies.

Zhu Xian, vice-president of the New Development Bank, also said the influx of advanced foreign experience and economic theories has played a crucial role for Chinese leaders and economists to define the steps to reform.

China's reform and opening-up has not only developed China itself, but also benefited the world. China has long provided relief to the poorest countries and promoted the building of a community of a shared future for mankind. It has contributed to around one-third of annual global economic growth in recent years and has become a major stabiliser for economic progress, an important driving force for globalisation and an active contributor to global governance reform. "China's pursuit of a market-oriented opening-up policy has driven economic development for four decades; China's development is important not only for China itself, but also for the global economy," said José Manuel Durão Barroso, former president of the European Commission and former prime minister of Portugal.

Promoting reform through development

Finance is the lifeblood of the real economy, and financial reform and opening-up is a crucial segment of China's economic reform. former vice-chairman of the China Banking Regulatory Commission and chairman of the Finance Center for South-South Cooperation, said that, with the continuous progress of reform and opening-up, financial system reform is carried out around the overarching requirements of national development, and finance plays an increasingly important role across the national economy. Before reform and opening-up, banks could be seen as vassals of finance, playing the roles of cashier and accountant. In the early stage of reform and opening-up, the banks became the main financing channel for economic and social development.

The top priority for financial development is opening-up, which promotes reform, competition and development. Zhou Xiaochuan pointed out the financial services industry is competitive and will be more so with deeper opening-up in the future. The entry of foreign banks obliges state-owned banks to learn from competition, which brings not only product evolution, market construction, new business models and management experience to China's financial services industry, but also applies pressure for reforms to domestic policies, including accounting and regulatory standards and the replacement of the business tax with a value-added tax.

The opening-up of the manufacturing industry has enabled China to become the world's factory, and many industries are moving towards the middle and high end of the global industrial chain

Some people – either out of self-interest or from their own research findings – argue for the protection of the Chinese financial sector until it is mature enough and strong enough to participate in international competition. However, the experience of other countries – including China itself – shows protection can easily lead to poor governance, weak financial constraints and rent-seeking behaviour. Instead of healthy growth, it dilutes competitiveness, harms the development of the industry and makes the market and its institutions unhealthy and unstable. At present, many domestic financial institutions have followed the 'Go Out' policy and adapted to international competition. Five financial institutions – four banks and one insurer – have joined the list of global systemically important financial institutions and banks and become market operation subjects with sufficient capital and sound operation. The financial services industry is not an exception to the manufacturing and services industries; it too must bend to the rules of competition and opening-up. In the process, it will develop more strongly because of the pressure, power, progress and prosperity brought about by the competition mechanism.

Financial institution reform is the basis of financial reform, the goal of which is to further improve the efficiency of financial resource allocation. Lu Lei, deputy director of the State Administration of Foreign Exchange, said China has made remarkable achievements in financial reform in the past, but it still faces the reform of corporate governance. The key issues here are soft budgetary discipline and moral hazard participation, where the task of reform remains daunting. Financial reform seems to prevent and control systemic risks; on the surface, it seems able to further allocate financial resources as the subject and channel. In other words, it determines who will allocate financial resources and who will ensure effective and moderate risks.

The reforms of the past 40 years have shown that money is the master floodgate, but monetary authorities are by no means the direct allocators of financial resources, and central banks can only correct the misallocation of financial institutions and financial market resources before or after the event. The leverage ratio is the total source of risks. Reducing the leverage ratio and improving the efficiency of serving the real economy must rely on the development of direct financing and equity investment institutions. Relying on indirect financing and a bank-dominated system, it is difficult to simultaneously reduce the leverage ratio and serve the real economy.

The cultivation of a prudent financial culture is a mainstay of financial development. Chen Wenhui, vice-chairman of the National Council for Social Security Fund, said financial institutions have paid the price over the past four decades for a lack of prudence and sound practice. As the scale of China's financial services industry grows, so does its concentration, rendering the disposal process increasingly difficult. In the future, more attention should be paid to a prudent and steadfast financial culture. In addition, the goal of financial supervision should be to maintain the market order of fair competition, protect the legal rights of financial consumers and maintain the stability of financial markets. For a long time China was unclear about this goal, and often unconsciously promoted development as a regulatory goal, which caused many problems, some of them fatal to businesses. In the 'new era' of Chinese politics and power, how the objectives of financial regulation are clarified is vital.

Onwards to openness and inclusiveness

Reform and opening-up is a journey with no end. On the 40th anniversary of China's launch of reform and opening-up, President Xi Jinping said: "Remain true to our original aspiration, keep our mission firmly in mind and continually carry out reform and opening-up."

In the new era, China must focus on total factor productivity and weak constraints. Zhu Xian, of the New Development Bank, said that, in 1985, the World Bank made many institutional suggestions on China's transition from central planning to a market economy. Most of the issues were later resolved through China's reform and opening-up, but some deep-seated institutional problems are still to be tackled during further and comprehensive deepening of reform and opening-up.

First, China must raise total factor productivity. Since reform and opening-up began, China has greatly improved efficiency in this field through system reform and technology introduction, and narrowed the gap with developed countries. The task in the next stage, however, remains difficult. In the process of establishing a modern economic system, total factor productivity needs to be further improved in the transition period from high-speed growth to high-quality development. Second, the bottleneck of weak constraint must be released. At present, the nominal debts of many local governments are low, but hidden debt risks are prominent. Where the market plays a decisive role in allocating resources, the issue of soft constraints has been largely effective in the past and will further unleash the dividends of reform in the future.

Zheng Zhijie, president of the China Development Bank, said upgrading China's economy requires focus on the following aspects:

1. Improving the level of the open economy.

2. Continuing to follow the innovation-driven development path. With the low-cost advantage of the economy declining, research and development capacity need to be further enhanced, raising the productivity of total factors of production, and transforming economic growth from reliance on resource and capital input to reliance on independent innovation and expansion of domestic demand.

3. Properly handling the relationship between the government and the market. While giving free rein to the government's role, the law of the market should be respected in lowering the threshold of market access, reducing market failures and trial-and-error costs, and allowing the market to play a decisive role in resource allocation.

4. Gradually narrowing the income gap between urban and rural areas and between different regions. This will increase support to rural areas that have been lifted out of poverty, revitalising the central and western regions and strengthening weak links in improving people's lives.

5. Encouraging diversified financial development, deepening reform of the investment and financing systems, improving financial ecology, establishing a co-operative system for diversified financial development, effectively reducing financing costs in the real economy, and preventing systemic financial risks.

According to the World Bank's *Doing Business 2019* report, China rose 32 places in the 'ease of doing business' rankings in a year: from 78th place in 2016–17[2] to 46th place in 2017–19.[3] But there is still plenty of room for improvement in China's business environment. According to Barroso, the European Union hopes China could continue to push reform and opening-up – including to foreign companies in the financial sector – further creating a level playing field for a more stable business environment.

At a time of fierce international competition and rising unilateralism and protectionism, China should stay committed to a capable running of its own affairs, developing its economy and raising the living standards of its people. Equally, China must unswervingly open up to the outside world and participate fully in global economic governance. China must keep advancing its reform and opening-up, making its economy more inclusive and interwoven into the global economy. The Chinese people will benefit from this great cause and contribute to world peace and development.

1. *Tim Worstall,* Forbes, *China's only 15% of the global economy but contributes 25–30% of global growth, October 2016, https://bit.ly/2sTm2JR*
2. *World Bank Group,* Doing Business 2018, *https://bit.ly/2xOgfqP*
3. *World Bank Group,* Doing Business 2019, *https://bit.ly/2Psyj4P*

From bust to boom – Lighting the fuse in 1978

Zhu Guangyao, IFF vice-chairman and former vice-minister of the Ministry of Finance of China, reflects on 40 years that have seen China transform from a World Bank loan recipient to the booming economy that has turned the world on its head

In the past 40 years, seismic changes have taken place not only within China, but in its relations with the rest of the world. Domestic living standards and China's international status have improved to unprecedented levels. As President Xi Jinping said in 2017: "China is getting ever closer to the centre of the global stage."


Zhu Guangyao

The Chinese economy has ballooned from RMB367.9 billion in 1978 to RMB82.7 trillion in 2017. Its foreign exchange reserves were US$167 million in 1978, yet today exceed $3 trillion. What impresses the world most is the improvement of people's wellbeing. Per capita GDP registered merely $220 in 1978, but in 2017 amounted to more than $8,800 and is set to exceed the goal of $10,000 this year.[1]

China's economy has grown at an average annual rate of more than 9% over the past four decades, benefiting Chinese people and making the entire world take notice.

The Chinese economy has grown at an average rate of more than 9% over the past four decades, benefiting Chinese people and making the entire world take notice

China embarked on its journey of 'opening-up' to the outside world during the process of deepening reform. Just weeks after the Third Plenary Session of the 11th Central Committee of the Communist Party of China in 1978, China accelerated the pace of its international integration and established diplomatic ties with the US in January 1979. It subsequently joined the International Monetary Fund and the World Bank in 1980.

China was once a recipient of the World Bank's soft loans, which helped develop its economy. Following an economic boom, almost 40 years on, China is now an important donor to the World Bank in alleviating poverty in other parts of the world. China has also offered aid to the poorest countries and increased grants to international financial institutions. After trying for 15 years, the nation became a member of the World Trade Organization in 2001. Through its membership of these three international organisations, China has continued to push ahead with opening-up by facilitating further reform.

However, despite having the world's second-largest economy, China remains a developing nation. President Xi has emphasised that reform and opening-up in China will be an ongoing process. The country's business environment global ranking has risen to 46th place from 78th, according to the World Bank's *Doing Business 2019* report.[2,3] But there is still room for improvement.

In the face of unprecedentedly fierce competition in global productivity and severe challenges of unilateralism and protectionism, China's top priority continues to be to enhance the lives of its people. In addition, China must firmly open to the outside world and unswervingly engage in global economic governance.

Almost four decades since China began opening up to the rest of the world, the country is now ready to begin the next phase of its journey, one that will be characterised by further reform, inclusiveness, openness and broader integration with the global economy.

1. *M Hong'e, ECNS,* China's nominal per-capita GDP to exceed $10,000 this year: report, *January 2019, https://bit.ly/2t9JRx1*
2. *World Bank Group,* Doing Business 2018, *https://bit.ly/2xOgfqP*
3. *World Bank Group,* Doing Business 2019, *https://bit.ly/2Psyj4P*

Financial deepening, fintech development and green financing

The commodity crunch – Free trade and futures

Jiang Yang, IFF vice-chairman and former vice-chairman of the China Securities Regulatory Commission, sees a a bright future in commodities trading and China's ability to adapt to a wide-open futures market

Jiang Yang

Since its acceptance into the World Trade Organization in 2001 and its integration into the global market, China has benefited from and contributed to global free trade. Over the past 40 years – during which time the country has strived to reform and 'open up' – China's import and export volume of goods has grown from US$20.6 billion in 1978 to more than $4 trillion in 2017. China's share of world economic output has risen from 1.8% to 15.1% over the same period and is the world's second-largest economy; as such, it is arguably the engine for the world's growth.

Trade in commodities has bolstered China's growth domestically and internationally. Bulk imports – such as iron ore, crude oil, soybeans and copper – have fuelled China's economic momentum, improved the living standards of the Chinese people, expanded employment, increased consumption and improved the wellbeing of many other countries.

Free trade of bulk commodities has enabled economies to benefit from others' resources, resulting in win-win scenarios. China's economy has burgeoned as the global economy has prospered. Between 2001 and 2010, China's contribution to global growth was 14.2%; in 2017 it rose to 33%. Along with other emerging economies, China has played a critical role in defining the next chapter of globalisation – in which countries must work together for global prosperity.

However, volatility in commodities prices in recent years has caused crude oil prices to fluctuate sharply, with Brent oil futures falling by 31% from over $80 per barrel to $50 within a month at the end of last year. The fall in prices can be attributed to political factors, supply and demand, and the strength of the US dollar. What is concerning is the critical role of commodities in sustaining global growth and economic stability of certain nations – either as exporters or importers.

Black gold

One of the most valuable commodities, with a strong influence over China's economic stability, is crude oil, on which more than 500 petroleum products and over 1,500 different industries are reliant. It powers the entire petroleum industry, valued at CNY4.04 trillion. In the same year, consumer goods refined by China's crude oil totalled 551 million tons, of which more than 400 million – about 70% – came from nations along the route of the Belt and Road Initiative (BRI).

Economising on commodities

Products derived from iron ore, from tools to aviation equipment, are today a major contributor to global growth. In 2017, China imported 1 billion tons of iron ore; industries were unable to sell the amount they were manufacturing. Iron ore price rose from less than $30 to $150 per tonne, while steel grew from $296 per tonne to $652 between 2002 and 2010.[1] China imported 65% of iron ore from the international market, yet domestic steel companies yielded relatively low profit margins due to a lack of pricing power.

Domestic steel mills managed to earn a small profit after iron ore futures were listed on the Dalian Commodity Exchange in October 2013. Profits per tonne increased from $40 in 2011 to $126 in 2017, saving about $10 billion across the entire industry.

China imported 97 million tons of soybeans in 2017, mainly from the US and South America. In addition to the direct consumption of soybean oil, most soybeans were used as fuel for the agricultural sector. China also imports a large amount of palm oil from Southeast Asian countries along the BRI. The importing and exporting countries of these commodities frequently capitalise on the futures market to manage price risks and maintain economic safety.

Importance of futures

The fluctuation of these commodity prices has a significant impact on business operations and national economic security. More than a century ago, the US and the UK – with the help of the futures market – mitigated or offset the impact of price volatility, proving that the futures market takes an indispensable role in stabilising commodity prices.

Trading commodities in foreign financial markets is generally referred to as futures trading – contracts for assets bought at an agreed price, but delivered and paid for later. The trading partners sign a commodity spot contract, which must be delivered – with a small margin – to control the risks of market price changes during the production cycle. Both parties shall honour their commitments as per the contract price at a predetermined date regardless of fluctuation. The financial trader closes the position and exits the trade before the delivery date.

Shanghai's crude oil futures could become a figurehead for customers trading in Asia

Yegor Gaidar, economist and former acting prime minister of Russia, believes the economic disintegration of the Soviet Union was caused by a fall in international oil prices. In his view, it is important for the governments of resource-rich countries to know beforehand what to do in the face of falling prices. Each government should anticipate its impact on the budget, balance of payments, consumer market, external debt repayments and stability of the banking system, while at the same time offering a detailed and practical action plan that can be practised in similar situations.

Crude oil made up the lion's share of income for the Soviet Union at the time, negatively impacting the country's budget and social living. The US and some of its allies sold much of their reserves in the crude oil futures market, pulling down the price of futures, yet the Soviet Union was hampered by politics and unable to follow. For crude oil exporters, no matter how many resources are exported, if the price falls so do the profits. The same goes for importers: a sum of money allows you to buy less oil if the price rises.

Large economies should therefore establish their own futures markets. Nobel laureate Milton Friedman of the Chicago School of Economics strongly supported the creation of the foreign exchange futures market on the Chicago Mercantile Exchange (CME). But while it is in the strategic interest of large economies to establish such infrastructure, smaller economies would find it impractical due to the high costs, limited space and ability to manage.

The commodity futures markets established by the US and UK more than 100 years ago are not just for domestic use. The CME – the most influential futures market in the world – is the international pricing centre of crude oil, agricultural products, gold and other bulk commodities. Many global economies, enterprises and investors trade in the US futures market and hedge out risks. The London Metal Exchange has a similar function, with the world's non-ferrous metals companies using its benchmark price to manage risks. Intercontinental Exchange in the US also functions as a global pricing and risk management institution with similar energy pricing and risk management.

China also has a futures market. It was established 30 years ago, is the largest in Asia and has ranked among the top performers in the global commodity futures market for nine consecutive years. However, Japan has a greater international influence than its larger neighbour. Rubber futures, for example, are traded dozens of times more on the Shanghai Futures Exchange than in Japan, yet the benchmark for international natural rubber trading is set in Japan, not China.

One of the main reasons for this is China has not opened its rubber futures market. International investors are unable to operate within the Chinese market, and relevant information on trading in international commodities is not directly and fully reflected in the price system in the futures market there. Countries and companies that buy and sell commodities will only be able to use the price found as a benchmark for negotiations when the price system shows the needs of all parties, and stores all the information as data.

China's futures market is gradually opening up to foreign investors, with Shanghai crude oil futures listed in March 2018. One of the biggest changes in the market since then is the Arabian American Oil Company's (Aramco's) changes to its 40-year-old pricing mechanism. Aramco used Oman crude oil futures, listed on the Dubai Commodity Exchange, as a benchmark, but used the Brent or Platts benchmark with Asian customers. According to industry analysts, this was because of supply. Within nine months of Shanghai crude oil futures' listing, its trading volume exceeded that of Oman crude oil futures by more than a dozen times, becoming the world's third-largest futures market. China could gradually replace the benchmark of Oman crude oil pricing with Shanghai crude oil futures for customers trading in Asia.

The market is maturing, and with daily and monthly trading volumes increasing more and more, international investors are equally likely to participate in the market.

1. *IndexMundi*, Iron ore monthly price, *https://bit.ly/2Bxqvq2*

Financial deepening, fintech development
and green financing

Fintech and the future – Improving financial literacy

Li Dongrong, president of the National Internet Finance Association of China and former deputy governor of the People's Bank of China, explains how financial technology can aid sustainable growth, transform the structure of financial markets and promote new standards of sustainability

Recent advances in technological innovation have led to improved attitudes and an interest in how technology can aid the regulation and supervision of financial markets, as opposed to the present focus on improving financial competition, co-operation and inclusion.

Positive development

Financial technology – or fintech – is transforming the structure of the financial market by facilitating the emergence of non-bank players and has had the following impact on financial markets:

1. **Accelerating the transformation of the global financial industry.** Financial development has always gone hand in hand with financial innovation. For example, the invention of smelting, papermaking and printing technology resulted in new methods of creating and distributing currency. Developments in communication, such as the invention of the telephone and telegraph, enabled finance to reach out to different classes more quickly. In the second half of the 20th century, the development of the computer – and later the internet – fundamentally altered the structure of the finance industry, resulting in automated and digital banking. Today, with technological development reaching unprecedented speeds, artificial intelligence, cloud computing, big data, blockchain and other modern information technologies have come to the fore. These inventions offer the industry a rare historical opportunity to evolve once more – this time into a network-based, digital and intelligent system.

2. **Promoting global inclusivity.** Financial inclusion initiatives have made great strides over time, promoting financial markets in many developing economies. Traditionally, some forms of finance are costly, unsustainable and inefficient for less developed markets. The World Bank calculates that around 1.7 billion people worldwide do not have a bank account,[1] while more than 65 million micro, small and medium-sized enterprises in developing countries are suffering a finance gap of US$5.2 trillion in credit.[2] But change is beginning to occur, and technology is bridging the gap. In countries such as China and Kenya, financial inclusion strategies have drastically reduced the number of people without access to banking services by leveraging technology to cut costs and widen the gamut of financial services.

Li Dongrong

3. **Sustainable growth.** Fintech also has the potential to aid sustainable growth. As more and more financial firms witness the benefit of technological innovation, the volume of investment into research and development (R&D) increases. Risk, as a result, is reduced as more labour and resources are directed towards technological development. In this respect, fintech has the potential to co-ordinate development in financial markets and across wider industries.

New governance challenges

The fintech sector is still maturing, and lingering financial governance challenges remain. One such challenge is the 'digital gap'. In the financial industry of every country, levels of technical development infrastructure, education and investment vary widely; in many countries contactless mobile payments are possible, whereas in others the nearest cash machine may be a walk of several miles away. According to the World Bank, 2 billion people do not own a mobile phone and nearly 60% of the population remains without access to the internet.[1] This gap in digital access and understanding will limit how many people can benefit from this fintech revolution.

In countries such as Kenya, financial inclusion strategies have broadened the availability of banking services

The second challenge is regulatory arbitrage. In some countries, a 'race to the bottom' occurs following policies that over-prioritise financial development. Regulatory trends around fintech tend to see new products or firms domicile themselves in less strictly regulated countries, or at least in countries more 'friendly' towards new entrants. If these products and services are to be made global, this issue needs to be monitored closely.

The third challenge arises if technological risk becomes 'contagious'. Given the openness and growing interconnectedness of financial markets, risks that evolve from technological advancement have a greater chance of leeching into other sectors of the economy.

Healthy and co-operative development

There are always two sides to development, and equal attention should be paid both to the risks and the benefits fintech has to offer. This new form of innovation should be approached with a positive attitude, but also with prudence. Only in this way can we truly seek to profit and avoid harm, and fully realise the socioeconomic value of fintech in a more secure way.

International consensus

After almost a decade of observation and in-depth discussions, the international community is starting to form a consensus on fintech. First, it should serve the development of the real economy, and improve the quality of financial services and the level of inclusiveness across the globe; it should integrate small and micro enterprises into the wider economy, while allowing people from all backgrounds to access financial services. Fintech should enhance consumer protection and improve financial literacy in a sustainable fashion. The financial industry is a long-cycle industry, and fintech must stay relevant over time and evolve in tandem with the broader sector without introducing unnecessary risks.

Characteristic development

Currently, there is no 'best practice' model for fintech. To judge by early experiences, every country should define its own principles around how it wants to utilise new technology. For example, in the absence of a high-speed mobile network, Kenya developed its own around a mobile messaging service that would allow money transfers. China has made full use of the advantages of the size of its market when it comes to tech, carrying out many initiatives in its own mobile money network. In the UK and Singapore, among other countries, there has been an increased focus on creating a welcome regulatory environment for fintech.

Stronger international regulatory co-ordination

China should make full use of existing international organisations such as the World Bank and the International Monetary Fund (IMF) to strengthen the assessment and risk monitoring of fintech developments and tackle cross-border challenges. At the same time, China should establish a mechanism for regulatory information sharing and an 'early warning system' to continuously improve cross-border supervisory capacity. In October 2018, the World Bank and the IMF developed the Bali Fintech Agenda, which examined the opportunities and potential risks posed by fintech and tendered many promising suggestions.

Domestically, co-operation is also vital. Forums, training and peer learning should be explored by government, industry and academia. Qualified institutions in each country are encouraged to broaden efforts in initiatives such as joint laboratories and co-operative R&D centres.

International standards

Nothing can be accomplished without standards. Under the aegis of the International Organization for Standardization and other international bodies, multiple standards apply, but there is no consensus. Three key topics – financial infrastructure connectivity, consumer protection, and fintech risk prevention and management – can act as building blocks toward a one-stop shop set of regulations.

Fintech holds promise, and financial markets are aware of this. The industry must now unite to ensure the sector matures in a controlled but innovative manner – one that can support the world economy, encourage financial inclusion, and spur growth.

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Financial deepening, fintech development and green financing

Fintech – The first financial revolution

Han Seung-soo, IFF co-chairman, former prime minister of the Republic of Korea and president of the 56th session of the UN General Assembly, welcomes financial technology as a force for innovation, but recognises policy responses must be synchronised at a national and global level

Two interesting and important reports were published on the topic of financial technology – known as fintech – in 2018: the *Global fintech hub index 2018* by the Academy of Internet Finance, Zhejiang University,[1] and the *2018 Fintech100* by KPMG.[2]

KPMG's report indicated three of the five top global fintech companies originated in China, with Ant Financial in first place, JD Finance in second and Du Xiaoman Financial – which recently split from parent company Baidu – in fourth.

Zhejiang University's Academy of Internet Finance research established that the Yangtze River Delta – comprising Shanghai, Hangzhou and Nanjing – is the top global fintech hub, overtaking Silicon Valley in the US.

Fundamentally, fintech is a phenomenon characterised by IT-based start-ups filtering into the financial industry. Therefore, the fintech ecosystem is similar to the start-up ecosystem, although the actors may differ. The fintech ecosystem can be approached as a network of the IT industry, government, large enterprises, start-ups, accelerators, incubators, private investors, universities and research institutes.

A fresh combination

Fintech is an amalgam of IT and the financial services industry. Without IT, there would be no fintech. A high level of development and sophistication in the IT industry is one of the most essential prerequisites for the emergence of fintech, as evidenced by the deep market penetration of the smartphone.

According to the Pew Research Center in the US, the total number of internet users in 2016 was 3.4 billion worldwide.[3] The global internet penetration rate in that year was 46%, an increase of more than 10% within a year.

The internet penetration rate in 2017 was high in North America, Europe and parts of the Asia-Pacific region. The Republic of Korea topped the rankings with 96% penetration, followed by the US with 89%, the UK with 88%, Japan with 76%, China with 71% and India with 25%.[4]

The highest smartphone penetration rate was also in the Republic of Korea, which recorded 94%, followed by 77% in the US, 72% in the UK, 68% in China and 22% in India.[5]

Han Seung-soo

According to the *EY fintech adoption index 2017*, the fintech adoption rate – defined as fintech users as a proportion of the digitally active population – was highest in China, with 69%, followed by India with 52%.[6] Third-highest was the UK with 42%, followed by the US with 33%, the Republic of Korea with 32% and Japan with 14%.

By combining smartphone penetration and fintech adoption rates, I have estimated the percentage of the population in close proximity to fintech in major countries. China was the highest with 47% of total population utilising fintech in 2016, followed by the Republic of Korea, the UK and Australia – each with 30%. It also shows that 25% in the US and 11% in India utilised fintech in 2016.

A revolution in personal banking

Over the past half century, successive innovations have sprung up in the financial sector, including the introduction of credit cards in the 1960s, cash machines in the 1970s and 1980s, and the new financial products in the wake of deregulation of bond and capital markets in the 1990s.

However, with the advent of Apple's iPhone in 2007, smartphones began to influence the way people handle, monitor and control their banking and finances, shifting towards more direct finance, away from the conventional methods of indirect finance that often necessitated various intermediaries and added costs and inefficiencies.

We are currently at a stage where the further development of fintech industry is inevitable. With the traditional banking sector still discredited in the aftermath of the 2007–08 global financial crisis, as well as the acceleration of internet penetration, this is a critical juncture at which fintech can only become a competitor and an existential threat to banks. Microsoft founder Bill Gates foresaw the fate of banks in 1994, saying: "Banking is necessary. Banks are not."

Indeed, within 10 years of the appearance of smartphones on the market, banks are being threatened as they have not been since the founding of Banca Monte dei Paschi di Siena in northern Italy in the late 15th century. This phenomenon is nothing less than the world's 'first financial revolution'. As blockchain – the distributed ledger technology – further develops, a second financial revolution may follow.

With almost half its population utilising fintech, China is emerging as a global leader in this field. The massive scale of China's market and a 'light touch' policy from its regulators and supervisors have bolstered China's fintech development in the early years.

Leveraging existing social media platforms, China's fintech services include several key areas: third-party payments by non-bank digital providers, peer-to-peer lending, internet credit including microlending, internet-based banking and insurance, digital wealth management and credit ratings.

Notably, large and dominant fintech players in China have reached beyond their traditional niche to other areas of the finance supply chain, building an integrated ecosystem of financial services that link customers with businesses.

Until the early 2000s, China had a poor financial infrastructure and low-trust culture. The credit card penetration rate was low – below 10% in the early 2000s. China accounted for less than 1% of global e-commerce retail transaction value a decade ago, but today that share has grown to more than 40%.[7] The penetration of e-commerce, as a percentage of total retail sales, now stands at 15% in China, compared with 10% in the US.

E-commerce giant Alibaba absorbed financial customers by launching Alipay in 2004, a safe and reliable electronic payment service to allay consumers' financial distrust. Alibaba won customer loyalty by using escrow services that served as e-commerce credit guarantees by making settlement deposits. Then smartphones emerged to drastically change the paradigm of the Chinese financial market.

As the money market rate exceeded the deposit rate controlled by the People's Bank of China, Alibaba promoted competition in the financial markets by launching Yu'e Bao, a money market fund, in 2013. The e-commerce company gained an advantage in the market via the vast amount of customer data it has accumulated over a long period of time. Since the success of Yu'e Bao, the business scope of IT companies has expanded to various fields of finance.

The traditional financial industry is thus experiencing an unprecedented challenge from a fintech industry bent on disrupting existing banking practices and revolutionising traditional banking services through faster exchanges of money at lower costs domestically and globally.

Fintech has the potential benefits of market efficiency, inclusion, quality of services, supervision and regulation, and creates opportunities to galvanise efficiency gains, by lowering transaction costs, for example.

It also facilitates access to financial services, enhances the effectiveness of supervision and regulation, encourages entrants into the financial industry with potentially new business models, and favours user-friendly and cheaper financial services.

Fintech can also support economic growth and poverty reduction by strengthening financial development and inclusion. Fintech can help millions of individuals and small and medium-sized enterprises leapfrog access to financial services at an affordable cost.

Markets at a crossroads

Rapid development also entails risk to financial markets. In China, online payment service providers operate in the shadow banking system; they pool cash from banks and invest in interbank certificates of deposit or microloans, resulting in credit and maturity transformation. Actual fund flows are difficult to monitor as these payments providers operate outside the purview of regulators.

Financial markets are at a crossroads, faced with maintaining stability against potential external shocks in the near term while providing new sources of growth over the medium term. In this context, policy responses should strike the right balance between enabling digital innovation and addressing risks in the financial sector.

To maximise the full potential of fintech, regulation needs to adapt to a changing landscape so that trust in the financial system is maintained. Regulations should ensure the potential risks associated with fintech are effectively monitored and addressed in a manner that does not unduly stifle innovation.

Regulatory responses to fintech must be proportional to potential risks, and regulatory perimeters may need to be reconsidered. A legal framework will need to adapt to keep pace with innovation and ensure proper calibration of new risks, legal certainty, predictability, and the balance between transparency and privacy.

Fintech can benefit supervisors and regulators also by facilitating regulatory compliance – or regtech. For example, artificial intelligence and machine learning can help financial institutions identify suspicious activity more quickly, and biometrics and metadata can verify the identity of customers and/or beneficial owners. The distributed ledger technology that underlies crypto-assets can be leveraged to improve information-sharing between market participants and regulators. Similarly, regulators can use fintech to enhance the efficiency and effectiveness of supervision – or 'suptech'.

Policy priorities may differ as the initial conditions of each national economy varies. But, considering the inherent global reach of these technologies, regional and international co-operation will be a key to developing effective policy responses.

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Carbon trading – Pricing out climate change

Edmond Alphandéry, IFF vice-chairman, chairman of the Euro 50 Group and former finance minister of France, sets out his arguments for a carbon price-based system of global emissions trading, through which higher, more predictable pricing can help combat the challenge of climate change

An excellent Chinese official public document, *China renewable energy outlook 2018*,[1] released in October 2018, is guided by the strategic thinking of the 19th National Congress of the Communist Party of China and describes the implementation of the 13th Five-Year Plan development guidelines in detail. This document makes strong and simple observations and suggestions – perhaps most importantly that "human-induced climate change is one of the most severe challenges faced by humanity and poses a tremendous risk to the sustainable development of society".

I could not agree more with this statement. Global warming caused by emissions will bring with it unusual political risk, including mass migration. Nothing less than life on earth itself is to be fought for.

The report also rightly stresses that "energy sector carbon dioxide (CO_2) emissions represent the largest source of greenhouse gases, and the reduction of CO_2 emissions in the energy system is therefore an integral part of building an ecological civilisation".

It presents two scenarios for the future, considering China's plans to completely overhaul its energy system by 2050: the "stated policies scenario", which assumes full and vigorous implementation of current state policies for the energy sector, and the "below 2°C scenario", which goes further in the reduction of CO_2 emission.

The two scenarios have three common features. First, the success of energy transition will depend on the industry sector, although industry dominates national energy consumption in China. Second, over time, the share of fossil fuels will need to decrease – coal, in the first instance – and be replaced by the new, dominant renewable energies: mainly wind and solar. Third, we should not fear or be hesitant about the impact this energy transition will have on the speed of economic growth and employment, since development of renewable energy and the demands of new clean-energy users will boost economic activities and more than offset the negative effects of reduced fossil fuel use.

These observations are relevant in all countries, as the entire world must cope with energy transition. The report's recommendations also have a universal dimension. First, keep coal reduction a key priority with strict control. Second, raise the deployment

Edmond Alphandéry

of renewable energy – namely wind and solar – to a new level in the next decade. And third, ensure a sufficiently high cost for CO_2 emission, also in the short run, to "create a more level playing field between fossil fuel-based power and renewable energy. Further measures should be considered as short-term solutions, including a carbon tax and/or a floor price within the carbon market. In addition, carbon pricing and carbon markets must include other sectors beyond the power sector."

Carbon pricing and climate change

This last recommendation leads me to focus on carbon pricing as a device to fight global warming. There follow two preliminary remarks on these observations, then an examination of why carbon pricing is superior to other measures in limiting emissions:

1. The right target must not be missed. It is not energy consumption, but consumption of energy at the origin of CO_2 emission. Fighting climate change need not and must not lead to Malthusian economic policies, which will undermine standards of living and create mass unemployment. The global population will continue to increase, mainly in emerging markets where the needs of the population are huge. Curtailing the use of fossil fuel energy should not be confused with shrinking the demand for energy.

Polluting fossil fuels are being phased out across China in favour of more renewable energy sources, such as wind and solar

2. The policy favoured by governments globally is to reduce carbon emissions through administrative measures, interdictions, fiscal incentives and public spending. One should not criticise these approaches, which are certainly useful – for example, closing the most polluting coal-fired power plants, as in China; subsidising renewables, thanks to tariffs paid by consumers, as in Germany; or giving the subsidies to households to reduce their consumption of fossil fuel energy, as in France.

But, for all their positive effects, these approaches are costly and their benefits to global welfare remain limited. Thus the best approach is via a market mechanism; when we implement markets for carbon, we can assume the market covers all emitted carbon and can be sure it is the origin of pollution, whoever is affected.

For the market – and for carbon – to exist, emission permits that can be exchanged should be introduced. In this market, we can control the volume of emissions – allowing the price of carbon to adapt locally – or the price of carbon can be fixed, with the volume of emissions permitted becoming indigenous to demand.

Fixed versus controlled

Two market systems currently exist: in the UK, for example, authorities fix the price; in the European Union and China, the trading system targets the volume of carbon emitted. The latter option is the least efficient because, by controlling volumes, the price becomes volatile and a very efficient proportion of the carbon price signal is lost.

When the EU introduced an emissions trading system in the mid-1990s, the price of carbon was €30 per tonne. Following the financial crisis it fell to €3 per tonne, where it remained for the best part of a decade. In 2013, the price of carbon increased to €25 per tonne, and is now decreasing again, to about €18 per tonne.

It must be emphasised that a significant, predictable and rising price of carbon is the best incentive for producers and consumers to shift their behaviour from highly carbon-intensive to low-carbon or even carbon-free products.

Common sense dictates that, with higher carbon prices, activities that generate high carbon emissions will cost more. There is a 'substitution effect' – to speak the language of the economist – towards sources of energy that emit less carbon. In the final analysis, getting rid of carbon – and therefore the problem of global warming – comes down to the level of the price of carbon.

There is a point at which carbon will simply be too costly for an economic activity to continue emitting it. A higher, predictable price of carbon is by far the most efficient device to fight climate change. In practice, a rise in the price of carbon raises the problem of feasibility, at least in the short to medium term, and the problem of competitiveness. If the price of carbon is raised too rapidly, some energy sources will become too costly, and lead to energy shortages and business closures.

These are reasons that predictable, incremental processes are proposed – for example, inflation plus a given year-on-year percentage increase would allow economic structures to adapt smoothly to the energy transition. The carbon price is, therefore, an incentive as well as a signal to follow the right path in the least painful manner.

A task force for change

But there is resistance. To overcome this, and to encourage the EU to adapt the carbon price-based system, a task force comprising high-level personnel has been launched in Europe.

China is considering the introduction of a similar device to complement and better equip the initiatives it has already launched, probably globally, and to contribute to settling the competitiveness risk argument. An initiative is also being instigated under the umbrella of the International Finance Forum, which is planning a joint meeting in Paris of Chinese and EU leaders to exchange ideas about carbon pricing.

By pushing forward with this initiative, both Europe and China are showing their willingness to face this major challenge for humanity together, with determination and efficiency.

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An open door to reform

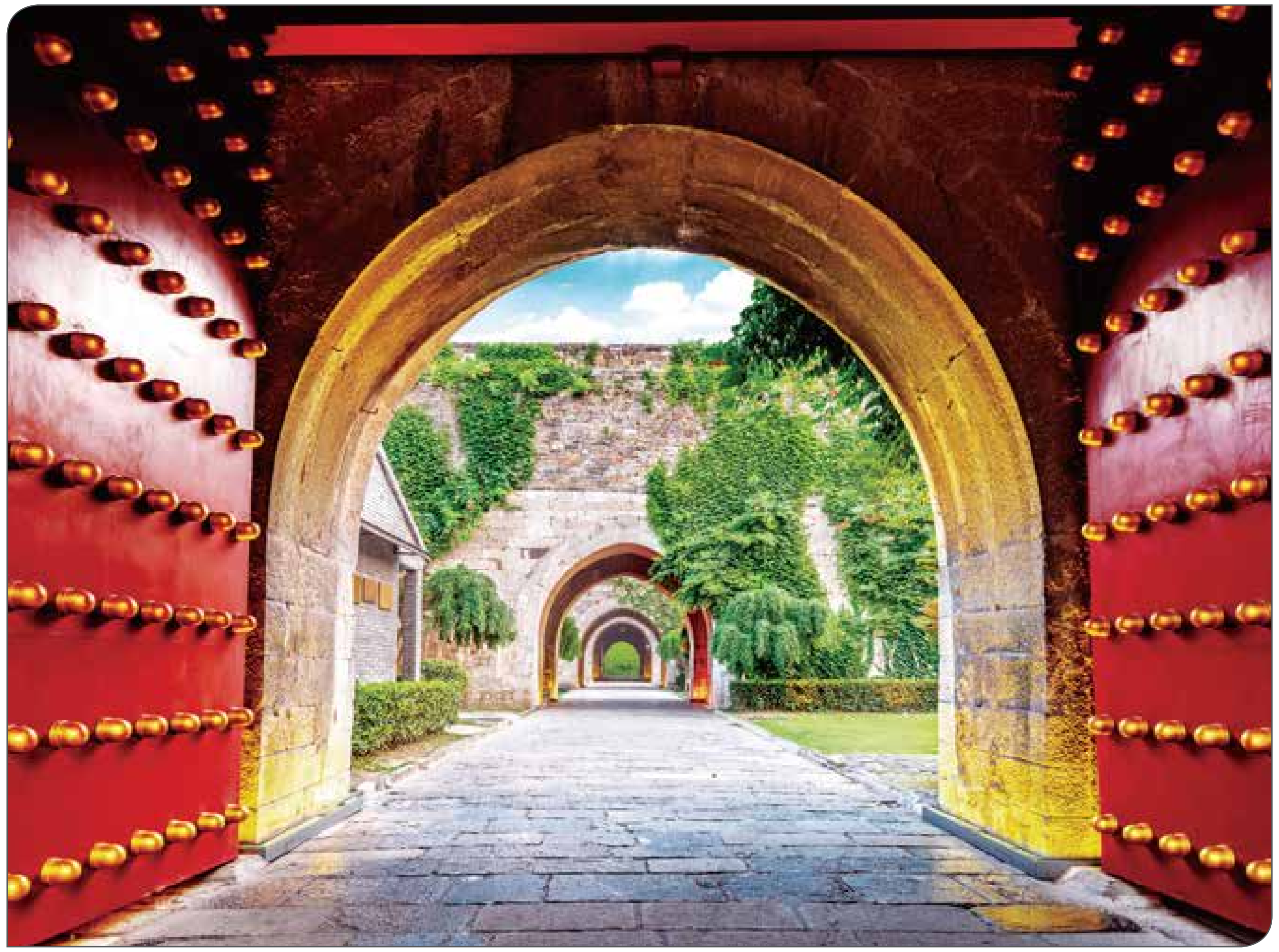
Lu Lei, deputy administrator of the State Administration of Foreign Exchange, discusses how structural reform and increasing investment and openness since 1978 have left China's financial services industry in good health, but recognises corporate governance overleveraging remain a threat

Finance exists in two dimensions: micro and macro. Macro refers to demand, currency, credit and foreign exchange policy, all of which influence economic growth and the price of commodities. Micro means financial resource allocation, or the supply side. Through the policy of 'opening-up', China aims to balance supply and demand by reforming financial institutions, monetary control and forex management systems, designing a new financial market, and advancing the liberalisation of the financial industry.

The Chinese financial experience

Forex markets, capital markets, financial instruments and money markets have a similar basic structure wherever they are in the world. But the way in which they operate and the structure of financial institutions differs in China because of the system they have been built around.

In 1978, at the Third Plenary Session of the 11th Central Committee of the Communist Party of China, the decision was taken to reform China's financial markets. In 1979, China moved away from a mono-banking economy, established the Agricultural Bank, the Bank of China and the China Construction Bank, and gradually set up regional joint-stock commercial banks and other types of financial institutions. By 1984, with the creation of the Industrial and Commercial Bank of China, which was tasked with financing the business activities of the state-owned enterprises, the People's Bank of China began to establish itself as the country's core regulator and central bank.



Lu Lei

In 1987, the operation mechanism of China's commodity-reliant economy was established, with the state controlling the market and the market guiding enterprise. In 1993, reform was accelerated to ensure that, by the end of the 20th century, China would have a fully fledged socialist economic system. Later that year, plans were set in motion to grant the central bank various macro tools and define the different functions of policy banks and commercial banks to form a more diverse and multilayered financial system.

Despite significant progress, China's financial industry is still prone to corporate governance issues. Soft budget constraints date back to the primary stage of reform and haven't changed significantly since. Some large institutions are systemically important and are unable to shoulder the responsibility when severe problems arise, while governments, regulatory authorities and central banks must weigh in to protect them.

In 1993, China began market-based interest rate reform. In 1996, it began to liberalise the interbank lending rate, and in 2000 adopted the creed of "large long-term deposit first, small short-term deposit after; foreign currency first, domestic currency after". Prices could now fully guide resource allocation, but only when the market could afford both profit and loss. However, the behaviour of financial institutions remains a problem. Ideally, net income should provide a buffer for banks when risks emerge, allowing instutitions to continue absorbing deposits and continue lending – if not, interbank lending comes into play. Thus, banks support the economy more during economic busts than booms.

Openness is crucial

Openness will stimulate reform. When the three dimensions of openness – the introduction of rules, mechanisms and competition – are established, the reform process can become increasingly standardised.

Banks unable to absorb bad loans start to build up debts. Through the implementation of the various Basel Accords, commercial banks have improved their capacity to deal with financial risks – increased capital requirements ensure the normal operation of a bank's activities but also protect consumers' deposits. There are too many cases worldwide of depositors suffering because of commercial banks becoming insolvent because of a lack of capital and excessive financial risk. Avoiding this requires self-restraint, and the capital adequacy ratio helps enforce this. Existing international rules are a good reference point for China, but are yet to be put into practice.

Investment is also crucial to reform, and Chinese banks have called on foreign institutional investors to accelerate reform within the country's banking industry. Many have since successfully listed outside the country and are examples of openness aiding the reform process. State-owned banks struggled during their transformation from specialised banks to policy banks to conmmercial banks. Since 2004, reform has centred on dealing with bad assets totalling RMB 1 trillion; bad loans only equate to 1.7% of total loans.[1] In 1994, China promulgated the first set of rules regulating the establishment of foreign banks and the administration of foreign-capital financial institutions, and took the first step towards introducing competition into the financial sector.

China's insurance industry is making up the most ground, having opened up two years prior, in 1992. As a member of the World Trade Organization, China has furthermore abolished regional restrictions on foreign insurance institutions setting up companies.

Resource allocation

Financial reform often entails new regulation to help prevent and control systemic risk. However, what should be the subject of this regulation and how risk should be managed is constantly debated.

In China, the central bank has headed up the financial system since 1979. However, a central bank should be responsible for correcting volatility in financial markets when things go wrong and should not dictate how banks should go about their day-to-day business.

Currently, the leverage ratio is the main source of risk. To reduce this, the central bank could implement capital constraints on financial institutions, but financing is required to fuel the economy. To achieve these goals, China must rely on the development of direct financing and equity investment, instead of indirect financing from the banking system.

We need to study in detail how financial markets behave and interact with one another. Innovation may lead to growth, but it can also introduce new risks that are not yet under control. There remains plenty of scope for financial reform, including the reform of financial institutions.

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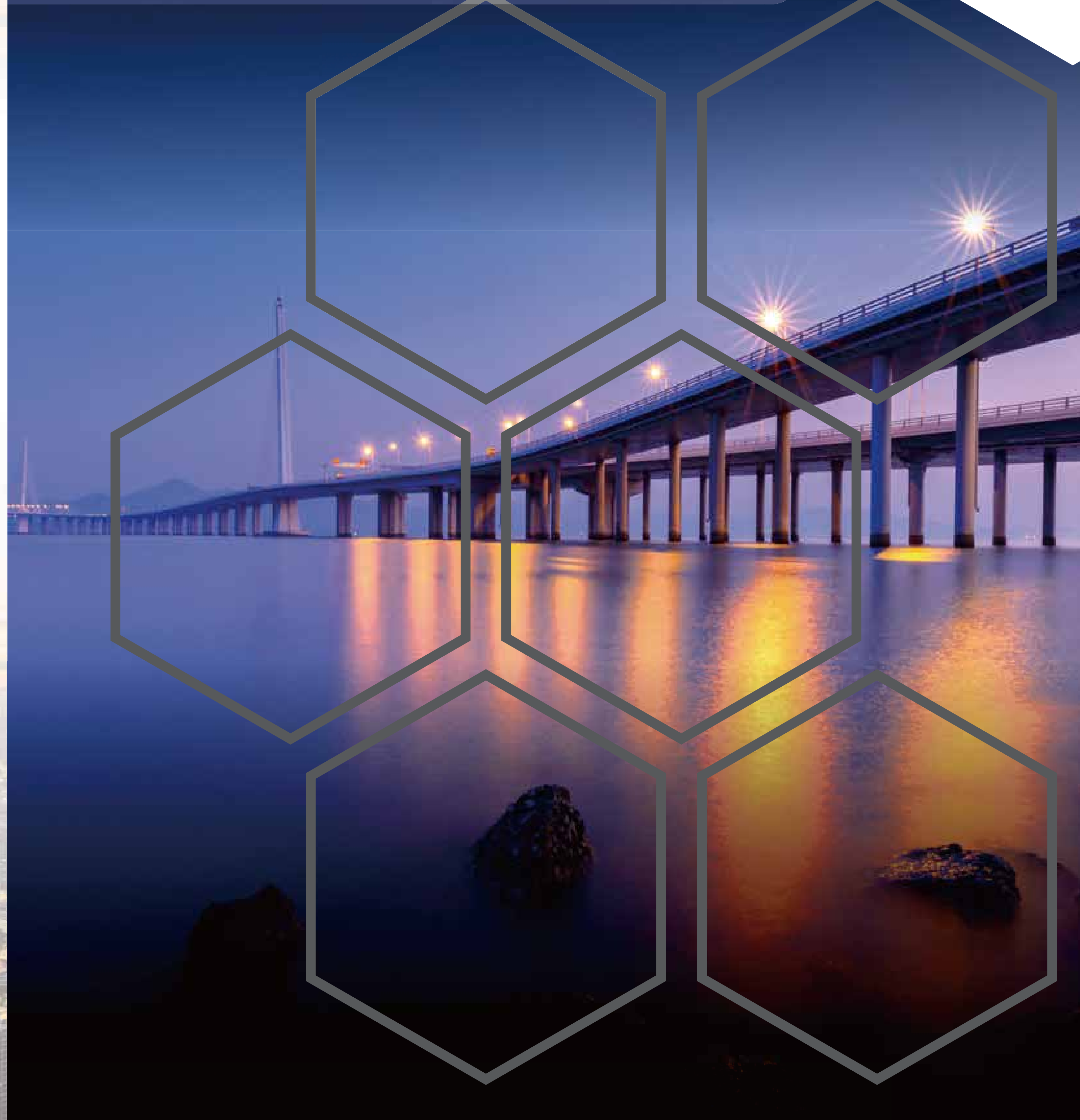
Financial Reform and Innovation Pilot Zone

THE BAY AREA DEVELOPMENT



Accelerated development in Nansha

Cai Chaolin, general director of the Administrative Committee of Guangzhou Nansha Free-Trade Zone, explains why prime-placed Nansha is becoming an education and healthcare hub and a centre for connectivity across the region

Cai Chaolin

Compared with the other three bay areas – those of New York, San Francisco and Tokyo – the Guangdong–Hong Kong–Macao Greater Bay Area has the largest land area and population, along with world-class high-throughput airports and seaports. Economic growth in the Greater Bay Area was 7% in 2017, far outpacing the other bay areas, and it ranks third of the four economically.

The per capita GDP of the Greater Bay Area is, however, the lowest of the four bay areas, at a little more than US$20,000, whereas San Francisco's bay area reaches around $100,000. Tertiary industry accounts for the lowest proportion in the Greater Bay Area, at around only 60%, with New York having the highest, at 89%.

The Greater Bay Area has the largest market capacity and the most complete industrial system of the four bay areas. The region covers nine cities in the Pearl River Delta and the two special administrative regions, Hong Kong and Macao, and radiates out to Guangdong and the entire south-east of China. This huge market potential is the mainstay of economic development here, and the Greater Bay Area should be fully confident in becoming the most economically active bay area in the world and a world-class city cluster.

Cities in the Greater Bay Area

Hong Kong, Macao, Guangzhou and Shenzhen are the four core cities, comprising the upper levels of a '1+3+7' model. Hong Kong is at the first level, Macao, Guangzhou and Shenzhen at the second, and the other seven cities make up the third. Hong Kong is the international financial shipping trade centre; Guangzhou is the capital of Guangdong Province, the traditional millennium commercial city and now a thriving trade centre; and Shenzhen is emerging as a new force in science and technology innovation, with its economic aggregate surpassing that of Guangzhou in 2017. According to 2018 Globalization and World Cities Research Network data, Guangzhou ranks 27th among the world's top international cities; Shenzhen ranks 58th. Hong Kong and Guangzhou are both classed as first-tier cities. In the financial index, Guangzhou ranks 19th, Hong Kong ranks third and Shenzhen ranks 10th. A comparison of these three cities reveals several particularly similar figures: total economic aggregate; growth rates (Shenzhen and Guangzhou are a little faster than Hong Kong); and the throughput of the airports and seaports. In 2018, Hong Kong handled more than 70 million airport passengers, Guangzhou 70 million, and Shenzhen more than 50 million. Shenzhen also has the highest container throughput.

The Nansha District, in the southernmost part of Guangzhou, has a unique geographical advantage at the geometric centre of the Greater Bay Area, with Hong Kong, Shenzhen and Dongguan to the east, Guangzhou and Foshan to the north, and Zhongshan, Jiangmen and Macao to the west. Nansha also has a distinct policy advantage as a national economic and technological development zone, a national new district and one of Guangdong's three free-trade zones. The Nansha Free-Trade Zone covers an area of 60 square kilometres, which is larger than the other two zones combined.

Furthermore, it undertakes the mission of comprehensive co-operation of the Greater Bay Area. Hong Kong and Shenzhen are highly developed, but there is limited space for further development. Nansha has an area of 803 square kilometres, with the concentration of urban development now approaching 20%. Of the 60 square kilometres of the free-trade area, approximately 38 are awaiting development. Nansha is also optimising its living and business environments: it places great importance on convenient transportation, high-end medical education, resource agglomeration, and culture, sports and entertainment facilities. With the operation of the Guangzhou–Shenzhen–Hong Kong high-speed railway, Nansha is only 30 minutes from Hong Kong, and metro lines connecting it with downtown Guangzhou will come into service at the end of 2020. Nansha will form a half-hour traffic circle with Hong Kong, Shenzhen, Dongguan, downtown Guangzhou, Zhongshan, Zhuhai and Macao.

The Nansha Passenger Port station of the Guangzhou Metro began operations in December 2017, further boosting the transport infrastructure of the Greater Bay Area

Education and healthcare

Hubs of advanced education and medical resources are expected to coalesce in Nansha. The Hong Kong University of Science and Technology has signed a framework agreement to set up a campus there, construction on which is expected to start in the first half of 2019. In addition, some of the best public education resources and international schools are situated in Nansha. In healthcare, Guangdong's best hospitals, including the First Affiliated Hospital, Sun Yat-sen University; Guangdong Hospital of Traditional Chinese Medicine; Guangzhou Women and Children's Hospital and Health Institute; Guangzhou First People's Hospital, Sun Yat-sen University Cancer Centre; and the Affiliated Hospital of Stomatology, Sun Yat-sen University, are located in Nansha.

Nansha's ecology is also outstanding. The average PM2.5 (the measurement of particulate matter in the air) in Nansha is 27 – which is moderate on the Air Quality Index. After two months of continuous monitoring, Nansha's water quality was classified as grade II, meeting the drinking standard of tap water.

At the same time, the business environment is also strengthening. The Nansha Free-Trade Zone has set a benchmark for reform and innovation nationwide. For example, in the enterprise registration, the examination and approval of industrial and commercial business licences and tax invoices can now be completed within one working day, and all matters related to pre-business examination and approval must be completed within three working days, standards comparable to the most advanced countries in the world. The Administrative Committee of Guangzhou Nansha Development Zone is accountable for carrying out reform and the policy of 'opening-up'.

Connectivity, complementarity and co-ordination

In a well-developed bay area, connectivity is paramount – particularly with regard to transport. In the Greater Bay Area, the construction of transport infrastructure is being accelerated. The opening of the Guangzhou–Shenzhen–Hong Kong high-speed rail link in September 2018 was a landmark. In October 2018, Guangdong held a discussion with Hong Kong chief executive Carrie Lam on the construction of rail transit in the inner bay area, to connect all nodes with the Hong Kong–Zhuhai–Macao bridge. Connectivity also includes the free flow of people and logistics, which has become far more rapid, and of capital and information, which still has a long way to go.

Each of the '9+2' cities has its own advantages and characteristics. They should draw on each other's strengths and develop each other in a unique way. Competition is the norm, but it should be orderly and co-ordinated.

Co-ordination refers to overall planning. Whether it is the bay areas of Tokyo, New York or San Francisco, the alliances between the three bay area cities play a very important role. The Greater Bay Area should, therefore, play the role of the central government, and provincial and municipal governments at all levels so we can work together to further accelerate development. ⬢

On the heels of the big three

Antony Leung, IFF vice-chairman and former financial secretary of the Hong Kong Special Administrative Region, argues that the Greater Bay Area's unique geographic advantages and determination to accelerate innovation is seeing it catch up with the bay areas of New York, San Francisco and Tokyo

Antony Leung

In 2002, I advised Tung Chee-hwa, Hong Kong's first chief executive, on two construction projects: a bridge stretching from Hong Kong to Zhuhai and Macao, and a high-speed railway between Hong Kong and Guangzhou that would reduce journey times to under an hour. My proposals were approved and incorporated into his municipal report. In September 2017, the high-speed rail link was completed and, in October, the Hong Kong–Zhuhai–Macao Bridge was opened.

The New York, San Francisco and Tokyo bay areas have evolved into powerful regions of economic development, generating around 60% of global GDP. The Guangdong–Hong Kong–Macao Greater Bay Area has the potential to be just as successful.

The Greater Bay Area comprises nine Cantonese cities and two special administrative regions, which complement each other neatly. Guangzhou is the leading political, economic, education and cultural centre in south China, with a world-leading manufacturing sector and the largest factory in the world. Shenzhen is one of the most innovative and dynamic cities in China, home to Tencent and other high-tech companies. Macao has one of the world's best entertainment and conference industries and, thanks to the 'one country, two systems' policy, Hong Kong continues to benefit from a favourable tax regime. The corporate tax rate in Hong Kong is 16.5%, while the tax rate for small and medium-sized enterprises has recently been reduced to 10%. Average personal income tax is 15%, while overseas income is not taxed, and there is no asset value-added tax or estate tax.

China has incorporated the development of the Greater Bay Area into its national strategy. President Xi Jinping has attached great importance to promoting economic development, suggesting the strategy does not just concern the development of the Greater Bay Area, but should encourage the whole of China to improve its economic standing in the future.

In August 2018, discussions took place at first vice-premier of the State Council Han Zheng's co-ordination group meeting. Here it was stressed the Bay Area Development should not obstruct or interfere with the implementation of the one country, two systems policy. To strengthen Hong Kong's position as a centre of international technology innovation, the central government is proposing setting up a research division of the Chinese Academy of Social Sciences. For the first time, Hong Kong's potential in the field of innovation is highlighted, and strengthening its infrastructure will help create an 'innovation corridor' running between Guangzhou, Shenzhen, Hong Kong and Macao under the leadership of the Politburo Standing Committee of the Communist Party of China, a national level co-ordination mechanism for the Bay Area Development.

A focus on development

Talent

Sourcing and retaining talent is the biggest challenge for any modern economy. Success in competition between large economies is contingent on the talent pool, the people driving the innovation. Both New York and San Francisco have a higher proportion of international talent: almost 40% of people working in these regions are from overseas. The proportion of international talent in the Greater Bay Areas is relatively low, accounting for less than 5%. Interactions with Hong Kong – one of the world's largest international financial centres – should widen the talent pool and provide another advantage to development. Hong Kong has a population of only 7 million people, and market demand is small. The region measures a mere 1,000 square kilometres and is mostly mountainous, with only one-third of its land habitable. But the Chinese mainland has both undeveloped markets and geographic space; Guangzhou's Nansha District, for example, covers 800 square kilometres, almost 80% of the area of Hong Kong. The two areas could complement each other well.

But mainland China can also benefit from resources in Hong Kong. Currently, it is beginning to feel the effects of an ageing population. In 2017, 17% of China's citizens were over the age of 60. As life expectancy increases and incomes continue to rise, people will require improved medical care. Mainland China has 1.7 doctors and 2.6 nurses per 1,000 people; in Hong Kong, this figure is 2.6 doctors and 6.9 nurses. In drawing closer to Hong Kong and building up training and management opportunities in the Greater Bay Area, China can attract talent from Hong Kong to settle on the mainland.

However, living conditions will need to be improved if China is to sustain international talent. In terms of culture and lifestyle, Hong Kong is one of the three most attractive financial centres in the world, and has four universities ranked among the top 100. Those universities could set up branches in the Greater Bay Area or co-operate with universities already established in the region to enhance academic strength and promote intelligence exchanges.

Advanced in scientific and technological development, Shenzhen is one of the most innovative and dynamic cities in China

THE GREATER BAY AREA IN NUMBERS

- Covers an area of 56,000 square kilometres, around 1.5 times the size of Tokyo's bay area and three times the size of New York's bay area.
- Has a population of about 70 million, equal to the existing three bay economic zones.
- GDP currently stands at US$1.4 trillion, a little behind that of the other three bay areas. However, GDP growth is accelerating and the region is expected to catch up with Tokyo soon.
- Receives 65 million containers a year, far more than the other three bay areas.

Finance

Hong Kong is already a global financial centre, while Shenzhen and Guangzhou are still developing their financial districts. China is now highly leveraged, and attracting investment is therefore crucial for the Bay Area Development. A focus on attracting venture capitalists and private equity is important; using Hong Kong's stock markets on which enterprise can list will help with the flow of direct finance.

Science and technology

Shenzhen is relatively advanced in the development of science and technology, yet falls short in biotechnology, which will be an important sector for promotion of human development. The US currently leads the way in this field, with Boston and San Francisco forming hubs for research and development. In April 2018, I suggested to the governor of Guangdong, Ma Xingrui, that Nansha or the Shenzhen–Hong Kong River Area – the Sham Chun River – should become China's biotechnology base. Academics, scientists, doctors and patients would be able to work in the region under the same regulatory rules as those in Hong Kong. At present, many medicines, animals and human tissue used in experiments are not accessible to mainland China, because of lengthy quarantine procedures that are in place, which means much of the research is conducted in Hong Kong.

By combining the strengths of its several cities and taking advantage of the existing political arrangement, the Greater Bay Area is well positioned to develop into a world-leading economic bay area.

Developing green finance in Guangzhou

Qiu Yitong, director of the Bureau of Financial Affairs, Guangzhou Municipality, lists the city's green finance infrastructure achievements, and calls for new policies to increase the speed and reach of energy-saving and environmentally friendly development

Qiu Yitong

In June 2017, Guangzhou was approved as one of five pilot zones established in China to promote green finance and assist state efforts to tackle pollution. The capital of the industrialised Guangdong Province, Guangzhou, on China's south-east coast, has been encouraged to develop credit mechanisms to support energy conservation and the reduction of emissions. Under the leadership of the People's Bank of China – and after more than a year of exploration and practice – Guangzhou has managed to create a favourable environment for green finance. Corresponding policies, market incentives and preliminary restraint mechanisms have been established, and green financial products and services have begun to emerge. Throughout the process, the region has gained a great deal of expertise in the sector.

The purpose of developing green finance is to develop funds that can be channelled into sustainable, energy-saving and environmentally friendly products and projects. Finding a way to standardise this is a prerequisite. Since the approval of the pilot area, Guangzhou has focused on creating a standardisation system and has begun exploring the viability of certification standards for these ecologically sound enterprises and projects.

There is also a need to analyse the commercial sustainability of green finance. Guangzhou has always been market-orientated, allowing the market to dictate where resources are allocated. Ensuring there are promotion incentives for businesses has been crucial; policies such as the '1+4' green finance policy portfolio have increased financial support for green finance. In addition, the Guangzhou branch of the People's Bank of China has implemented policies to expand the number of firms eligible for green credit.

Financial products and services also need to be upgraded to match the financing needs of green projects. Financial institutions in Guangzhou have taken action – banks have upgraded their sub-branches to green branches or set up green financial business units and financial innovation centres; green financial debts have been issued; green insurance products and corporate bonds have been introduced. The Guangzhou municipal government is also considering issuing market bonds to support green welfare projects, while the equity centre has also set up environmental protection sectors.

Stability is also of the utmost importance, which is why the region is currently constructing a green financial risk prevention and resolution mechanism. The framework will strengthen the tracking, monitoring and evaluation of green credit, and firmly uphold the bottom line of risk.

For businesses to take advantage of the opportunities offered by the Guangdong–Hong Kong–Macao Greater Bay Area, certain policies should be enacted:

- A statistical index system to regularly release project information and guide investment in green industries.
- A unified green standard for the Greater Bay Area.
- Stronger connectivity between capital markets within the Greater Bay Area. Hong Kong is an international financial centre and an offshore renminbi centre. Macao is an important conduit to Portuguese-speaking countries, while Guangzhou and Shenzhen are regional financial centres on the mainland. The Greater Bay Area Development must clarify the different function of each city within the region to expand financing channels for green projects, and attract domestic and overseas investment to support green development.
- A green project database to share project information among financial institutions in Hong Kong and Macao. In the meantime, banks should promote and co-ordinate their loan offerings, providing financial support for green enterprises and projects.
- New types of futures exchanges, which must allow ecological products and carbon emission trading.
- A campaign on green finance and strengthened communication with overseas counterparts to enhance the Greater Bay Area's international influence. Perhaps a green finance alliance could be created to strengthen institutional co-operation and industrial self-discipline. ⬢

The cities that never sleep

Robin Xing, chief China economist at Morgan Stanley, explores the reasons behind the rapid growth of China's urban agglomerations, and a future of efficient transportation, advanced industrial chains and a transformation in productivity

After 40 years of reform and the policy of 'opening-up', China is no longer a planned economy. The Guangdong–Hong Kong–Macao Greater Bay Area is an important part of China's urbanisation strategy 2.0, the *National New Urbanization Plan*.[1] China's ageing population is expanding rapidly, and capital and labour inputs to the economy are gradually declining. The national supply-side structural reform programme has five priority tasks – corporate deleveraging, cutting excessive industrial capacity, destocking property inventory, lowering corporate costs and improving weak links – but the key objective is to further promote urbanisation. Not, however, by relying on a few relatively developed megalopolises, but looking towards urban agglomerations.

New growth in satellite cities

Spillover is a prominent feature of urban agglomerations, which connect satellite cities with central cities and, as a result, a unified labour market and a complete industrial chain emerge. It becomes more convenient for people to meet and communicate, which produces a spillover effect in knowledge.

The inflection point was in 2010, when China's high-speed railway began to roll out at scale in the Yangtze River Delta (YRD). Now, a journey between Wuxi and Shanghai can take as little as 30 minutes. Previously, economic development had been driven by the megacities, such as Shanghai and Hangzhou, but today the pace is set by satellite cities, with more rapidly transforming economies and smaller income gaps compared with Shanghai. The transportation infrastructure in the Greater Bay Area is lagging behind the YRD, although headway was made in late 2018. There will be around 10 intercity railways in operation by 2025, including the Shenzhen–Zhongshan Bridge, an enhancement of connectivity that will greatly boost productivity. Five major urban agglomerations in China – Beijing–Tianjin–Hebei, the YRD, the Pearl River Delta, the Middle Yangtze River and Chengdu–Chongqing – can be compared with other internationally successful urban agglomerations, such as the bay areas of New York, San Francisco and Tokyo. But China's five major urban agglomerations have three advantages over the others that can be further exploited:

1. **Large population base and high density.** At present, Tokyo is considered the largest urban agglomeration in the world, but the average number of population per agglomeration in China is 110 million – almost twice that of the Tokyo capital economic circle. The advantage of a large population is it can absorb more industrial chains and more working and industrial modes. As trade friction between China and the US continues, some are concerned production chains will be removed from China, but it would be difficult to move if other places do not have the large population base and density to sustain factory transfers. Many European multinationals and investors often wonder why China's internet and sharing economies – such as food delivery and car/bicycle sharing – are booming. It's a matter of population. Take, for example, the UK: no city other than London can grow its sharing economy. The UK's second-largest city, Birmingham, has a population of only 1 million, while the Greater Bay Area has seven satellite cities, with populations ranging from 2.5 million to 3 million. Population is the cradle of this economic pattern.

2. **High efficiency in transportation.** China has the world's largest and most complete high-speed rail network. Since the opening of the Guangzhou–Shenzhen–Hong Kong high-speed railway, it takes only 47 minutes to travel from Hong Kong to Guangzhou South station, the equivalent of travelling between Los Angeles and San Diego. From the central business district (CBD) of Hong Kong to that of Shenzhen, it takes less than 30 minutes. In the world's bay area cities, it is rare for two adjacent cities with such large populations to facilitate travel from one CBD to another in this time. With further development and roll-out of the 5G network, there will be improved face-recognition technology, which will also cut queues for security clearance and allow more rapid travel.

China's five major urban agglomerations


Robin Xing

3. **Flexible policies**. China has introduced many policies to actively assist urban agglomeration development, such as differentiated household registration and employment and social security policies. The nation will further open up the household registration system, public resources, medical care, education and other supportive facilities for small and medium-sized cities. The population of Beijing has seen negative growth, while that of Shanghai has stagnated. The average annual growth rate of surrounding third- and fourth-tier satellite cities is more than 1.5%.

Flexible policy can drive the further rise of total factor productivity. The Greater Bay Area has a more advanced and co-ordinated industrial chain than its rivals – Guangzhou, Dongguan, Foshan and Shunde are leaders in high-end manufacturing; Shenzhen is the world's foremost IT innovation city; Hong Kong and Shenzhen have a cutting-edge financial industry; and Zhuhai and Macao have long-established entertainment industries. The Greater Bay Area industrial chain aggregation and co-operation is unique; what is more, it is the centre of world-class shipping.

The synergy of capital markets in the Greater Bay Area is taking shape. Hong Kong is open to start-ups, technology and biotechnology companies. Two-thirds of China's patent applications come from Guangdong, and many private companies apply for patents and innovate on their own. Hong Kong gives full rein to its legal system and arbitration and professional services. This strengthens the intellectual property rights and patents of foreign and private enterprises, which attracts more foreign investment and further protects private enterprises taking the initiative to innovate.

The Greater Bay Area has great potential, but it needs further reform; currently it resorts too often to Hong Kong's innovative advantages to expand its opening-up. In view of local strengths and potential further reform and opening-up, it is estimated that, by 2030, the population of the Greater Bay Area will reach 88 million and its GDP will increase by nearly US$4 trillion. That would make it the fifth largest economy in the world, surpassing the UK, with a GDP of approximately $45,000 per capita. These estimations are based on the current advantages of the Greater Bay Area and the *National New Urbanization Plan*, as well as Guangdong's intentions to further create a showcase of reform and opening-up.

1. *China Central Government Portal*, National New Urbanization Plan, *March 2014, https://bit.ly/2S0b0R5*

Go your own way

Denis Depoux, deputy head, Asia, at Roland Berger, says China can be inspired by European examples of manufacturing infrastructure success, but it must draw up its own region-specific plan to unleash technological innovation and turn the Greater Bay Area into a world leader

Integrating bay areas within their wider regions takes longer and costs more than expected. Political willing and planning are vital, but the success of integration also hinges on the distribution of labour and resources across the region.

Competition between different areas – even between city blocs – means constructing bay areas for the best resources is pivotal. Connecting various regions is not always possible, and ensuring adequate planning and co-ordination is in place is vital.

Planning is also essential to allow companies and corporations within the region time to allocate capital to the project. Regardless of ownership, some firms may need to restructure to develop a more efficient form of product distribution.

One of the biggest challenges with constructing the Guangdong–Hong Kong–Macao Bay Area Development was the massive restructuring and transformation of the manufacturing sector linked to both Shenzhen and Guangzhou. The sector needs to harness technological advances to ensure innovation is not suppressed within a sector that has dominated the region.

A very interesting and successful example is the Rhine–Meuse–Scheldt Delta. Running across the Netherlands and Germany, from Rotterdam to Duisberg, the delta supports many industries, including automotive and chemical. It has become one of Germany's greatest strengths and generates much of the country's trade surplus.

While co-ordination between Germany and the Netherlands was vital to the success of the project, it was down to the drive of several large flagship companies, including a German chemical giant that used the infrastructure along the river to allow it to export.

Another very successful European economic integration project is the reunification of Germany. Immediately after the fall of the Berlin Wall, the capital experienced a boom in the construction industry. Redevelopment initiatives saw Berlin turn into one of the largest construction sites in the world.

A non-European experience

The Guangdong manufacturing sector needs uplift. One method to co-ordinate the economic integration across the region is to leverage transformation once it occurs. Unlike in Europe, Chinese projects of a similar scale are not subjected to the same laws. In the Dutch/German example, the European Union internal market played a key role in driving the initiative forward. This is something China could learn from.

Denis Depoux

In summary, there are five key elements to a successful redevelopment project:

1. Political leadership and determination. The alignment of decision-making is very difficult to achieve, as integration and construction take time.

2. Complementary industrial and social efforts. This must be driven by market forces to ensure resources are allocated efficiently.

3. Demand pool. The biggest asset of the Greater Bay Area is the immense pool of demand lying to its north; there is also the potential to export goods, despite the slump in international trade.

4. Geographical advantages. The surrounding environment and potential way of life in the region often attracts investment. Shanghai is a prime example of development resulting in a financial hub.

5. Total factor productivity. If a region is not productive, transformation will be unsuccessful. The best way to measure the innovation of the area is to see how much investment in infrastructure is occurring.

The tried and tested success of the European initiatives will not work in China, but it can learn from them. Attempting to implement the same policies and plans in China would be artificially bridging the gap. Manufacturing needs to pick up in the region; once it does, it will act as the driving force behind the project.